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AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

HEARINGS BEFORE THE SUBCOMMITTEE ON COMMUNICATIONS OF THE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 611

TO AMEND THE COMMUNICATIONS ACT OF 1934, AS AMENDED,
TO PROVIDE FOR IMPROVED DOMESTIC TELECOMMUNICA-
TIONS AND INTERNATIONAL TELECOMMUNICATIONS, RURAL
TELECOMMUNICATIONS DEVELOPMENT, TO ESTABLISH A
NATIONAL COMMISSION ON SPECTRUM MANAGEMENT, AND
FOR OTHER PURPOSES

AND

S. 622

TO AMEND THE COMMUNICATIONS ACT OF 1934 IN ORDER TO
ENCOURAGE AND DEVELOP MARKETPLACE COMPETITION IN
THE PROVISION OF CERTAIN SERVICES AND TO PROVIDE CER-
TAIN DEREGULATION OF SUCH SERVICES, AND FOR OTHER
PURPOSES

APRIL 27, 30, MAY 1, 2, 3, AND 9, 1979

PART 2

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AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

FRIDAY, APRIL 27, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 2 p.m. in room 6226, Dirksen Senate Office Building, Hon. Barry Goldwater presiding.

Senator GOLDWATER. The meeting will come to order.

You gentlemen, members of the panel—Mr. Bresnan, Mr. Arlow, Mr. Koch, Mr. Leghorn, and Mr. Onstad, will you please be seated. And because Mr. Onstad has an airplane to catch, we will let him begin.

You gentlemen can testify by reading your full text, if you want to, or summarize and we will include your full statement in the record.

STATEMENT OF PHILIP C. ONSTAD, MANAGER OF TELECOMMUNICATIONS POLICIES, CONTROL DATA CORP.

Mr. ONSTAD. Mr. Chairman and members of the subcommittee, my name is Philip C. Onstad and I am manager of telecommunications policies for Control Data Corp. My area of responsibility includes domestic and international telecommunications policies as well as security and privacy policies for data processing service offerings.

I have been involved in matters of international telecommunications and transborder data flows for a number of years. I am chairman of the International Relations Committee of the Association of Data Processing Service Organizations, ADAPSO, and vice chairman of the Telecommunications Committee of the Computer and Business Equipment Manufacturers Association, CBEMA.

I participate in the work of the United States Organization to the Consultative Committee for International Telegraph & Telephone—CCITT—and have been privileged to be a member of the U.S. delegation to the CCITT Study Group III on rates, tariffs, and regulations.

Control Data is a worldwide supplier of data processing systems, equipment, and services, as well as financial and educational remote computer services and specialized services that use all types of switched and private line telecommunications as the transportation medium between Control Data's computer centers and the terminal equipment of its worldwide customers.

Control Data's computer centers, when combined with communications, meld together to form a worldwide data processing net-

work that allows users almost anywhere in the free world to have unlimited computer power at their fingertips. Remote computing, or time-sharing, allows many users to share a single data processing system and also to share the cost of it, thus lowering the cost to each user.

Control Data has in the past and continues to vigorously support deregulation of all but the very basic communications services in the United States. And, in a related area, Control Data strongly advocates that no new restrictions be applied to the information processing industries. Control Data vigorously supports the doctrine of maximum separation, which requires subsidiaries if regulated carriers engage in offering unregulated products and services of any type.

Maximum separation has been tried before and has worked. The Service Bureau Corp., of which I was an employee, was separated from its then parent company, IBM, under a consent decree in 1956. It was then acquired by Control Data and is today a successful division of that company.

You will have an opportunity to hear more about maximum separation and how it has worked in the testimony of ADAPSO, which will be presented by the former general counsel of the Service Bureau Corp. Therefore, I will not elaborate on this issue.

Today I would like to comment primarily on the sections of S. 611 and S. 622 regarding international telecommunications.

Information processing is an important and growing area of world trade and accounts for a significant positive balance of payments for the United States. It has important ramifications for foreign policy, national defense and economic growth. The United States is second to none in the development and applications of technology and electronics, information processing, and telecommunications. Continued U.S. leadership in these fields is critically important.

Some countries are concerned with the U.S. leadership in telecommunications and data processing and have placed restrictions on the use of international telecommunications services.

Some of these restrictions are:

One, replacing full-period, international, private-line service by a service which utilizes usage-sensitive rates;

Two, transferring all data transmission to value-added networks which are often less efficient for users who transmit high volumes of data;

Three, pricing services on a value-of-service basis, rather than on a cost-related basis.

These actions would either increase prices or impose technical restrictions which would result in loss of efficiency for U.S. firms. This tends to form artificial trade barriers which limit the ability of U.S. firms to compete effectively in world markets. Availability of telecommunications to transmit information of all types affects the economic well-being of all industries. Restrictions on information flow hamper the ability to carry on business.

While Control Data is an advocate of deregulating the domestic telecommunications industry, it is extremely concerned with any changes in the regulatory policies concerned with international telecommunications services. Before any changes in international

telecommunications policies are made, serious consideration must be given to the international implications and side effects of such changes.

Control Data's position is that any move to deregulate or modify regulation of international telecommunications without first establishing a workable international environment through detailed negotiation in bodies such as the CCITT would be detrimental, not only to the U.S. telecommunications users, but also to users in other countries.

If a workable international environment is to be maintained, certain uniform policies must be agreed upon. And the United States must be prepared to play an active role in the policymaking procedure.

Now, I would like to comment on several points relating to international telecommunications policy in the proposed legislation. We have read the bill and have attempted to analyze the sections pertaining to the proposed International Facilities Management Corporation, which begin with section 242 of S. 611.

Generally, we feel that S. 611 has taken a rather innovative approach and one which may solve a number of problems regarding international telecommunications services and facilities. However, we are concerned with several points—the composition of the corporation's Board of Directors, as outlined in section 243, and the function of the corporation, section 244, subparagraph 2, which states the corporation is authorized to “participate as the designated U.S. representative in all planning and negotiations with foreign entities on matters related to the construction, operation, and use of international transmission facilities.”

While we do not think that it was the intent of the bill to give international policymaking powers to the corporation, the statement that I have just quoted leaves open the question of who has the policymaking authority, and we have not been able to find this question answered by any other sections of the bill.

Now, if you will, allow me to comment further on the first point I raised concerning the makeup of the corporation's Board of Directors. Control Data is deeply concerned that the provisions made for meeting the needs and requirements of “users” is very inadequate. Only three members of the Board will represent users, and those three will “be selected by the 20 end-users which had the largest amount of expenditures for international communications in the calendar year immediately preceding such selection. Each such user shall be entitled to voting rights proportionate to such relative expenditures.”

First, this provision could very well lead to the three largest users being represented on the Board, since they would have the most votes. And beyond this, regardless of which three users are selected, users would have only a minority position on the Board. The likely result is that the U.S. position on international telecommunications policy may not represent the wide spectrum of international telecommunications users.

To alleviate this, Control Data suggests that more users be represented on the Board of Directors of the corporation, and that those directors be selected in a more equitable manner that would allow

for the requirements of all users, both large and small, to be satisfied.

The second point that I want to make concerning international telecommunications policy relates to the pressing need for the United States to exercise more active leadership in the formation of international telecommunications and information policies and standards, within such groups as the CCITT and the Organization of Economic Cooperations and Development. Today, the U.S. participation in this area is very limited. For example, at present there are only four official U.S. delegations to represent United States positions and protect U.S. interests in the work of more than 30 CCITT study groups and panels.

It is absolutely essential that the United States take a more active role and a very positive leadership position within such groups to assure the establishment of policies which will balance the needs of offerors and users of telecommunications services which best suit needs from both a price and technical standpoint.

Third, Control Data recommends that the U.S. Government avail itself of the immense expertise available—in both the Government and private sectors—to represent the United States on international telecommunications policymaking bodies. The expertise is available today from both the Government and private industry to insure that this is carried out. The United States should not arbitrarily limit the size and number of delegations to international policymaking groups. We have the expertise available; we should put it to use to further the public interest.

Fourth, the United States should establish or designate an entity within the Government with the authority and responsibility to assure that, once international telecommunication policies are established, they are adhered to by all countries, and any violations are rectified. Without a strong, single policymaking entity with enforcement authority, there can be no meaningful U.S. international telecommunications authority.

Thank you for allowing me the time to offer my comments this morning. Because of time constraints, I would appreciate your leave to submit more detailed written comments.

I hope that you will seriously consider the suggestions made on behalf of Control Data. We strongly believe that they will benefit both the United States and the telecommunications and data processing industries.

Thank you, Mr. Chairman. [The following information was subsequently received for the record:]

SUPPLEMENTAL STATEMENT OF PHILIP C. ONSTAD, MANAGER OF
TELECOMMUNICATIONS POLICIES, CONTROL DATA CORP.

The statement that follows is a supplement to the testimony delivered on behalf of the Control Data Corporation (Control Data) before the Subcommittee on Communications of the Committee on Commerce, Science and Transportation on April 27, 1979. This statement contains responses to questions asked by members of the Subcommittee and by its staff.

In this earlier testimony, Control Data expressed deep concern about the ramifications of legislation making any significant changes in United States participation in the international telecommunications environment if no detailed analysis had first

been made of the effect of the changes. Control Data testified also that there was a great need for more and better leadership by the United States in the international telecommunications area, and pointed out that this problem was one of many in the area of international telecommunications policy. Control Data was asked to make suggestions about how to ameliorate these problems.

The importance of improving the U.S. posture in the field of international telecommunications is underscored by the growing role of information in international trade and commerce. Information has become a product of critical and basic importance in international trade, much like petroleum. Like petroleum, world trade in information requires the existence of an effective world-wide delivery system, that is, of effective, world-wide telecommunications media.

Specific recommendations on ways to deal with the broad issue of how the United States can most effectively participate and exert leadership in the area of international telecommunications can best be understood if deficiencies in the current method of United States participation in international telecommunications are made clear.

A. THE PROBLEMS

1. There is no central authority to establish overall policy for the United States regarding international telecommunications

Today, there is no coordinated, articulated international telecommunications policy for the United States. There is no single governmental body that has the charter to create and maintain such policy.

The United States must participate in many international bodies where telecommunications policies are set, such as the World Administrative Radio Conference (WARC), the Consultative Committee on International Telephone and Telegraph (CCITT), the Consultative Committee on International Radio (CCIR), and the International Frequency Registration Board (IFRB). (The latter three are part of the United Nations International Telecommunications Union (ITU) Convention.) In addition, in order to establish or use international circuits, United States telecommunications carriers and users must deal with the foreign agencies, ministries or administrations of each nation to which there is an international circuit. These government entities create and articulate international telecommunications policies for their governments. U.S. carriers must also often deal with government-controlled foreign carriers. There is no single governmental body to establish the U.S. policy to be applied in these different international telecommunications forums.

There are, however, at least three entities in the United States Government which purport to have responsibility in the area of international telecommunications: (1) The National Telecommunications and Information Administration (NTIA) of the Department of Commerce; (2) the Office of International Communications Policy at the Department of State; and (3) the Federal Communications Commission (FCC). (Some matters are also partially handled through the White House telecommunications policy staff.)

No one of these government entities is charged with ultimate authority to and responsibility for U.S. international telecommunications policy. NTIA is chartered, *inter alia*, to "serve as the President's principal advisor on telecommunications policies pertaining to economic and technological advancement . . .", to "[d]evelop and set forth, in coordination with the Secretary of State and other interested agencies, plans, policies and programs which relate to international telecommunications issues, conferences and negotiations; . . . coordinate . . . preparations for U.S. participation in international telecommunications conferences and negotiations; provide advice and assistance to the Secretary of State with respect to international telecommunications policies to strengthen the position and serve the best interests of the United States in the conduct of foreign affairs . . . [and] provide for the coordination of the telecommunications activities of the Executive Branch. . . ." United States Department of Commerce, Department Organization Order 10-10, § 6, ¶¶ .01, .04 and .05, issued May 12, 1978, effective May 11, 1978.

The Office of International Communications Policy at the State Department is part of the Deputy Assistant Secretaryship for Commercial and Telecommunications Affairs. Its very vague charter is to "develop policy recommendations and approved policy programs concerning international telecommunications." Organization and Functions, Foreign Affairs Manual, Department of State, Vol. I, Section 312.2. The FCC, given broad statutory authority to regulate "world-wide wire and radio com-

munication by wire or radio" and "foreign transmission of energy by radio," 47 U.S.C. §§ 2, 3(f), as a practical matter, regulates international telecommunications policy, facilities and service through its Section 214 construction authorization authority and through its authority to regulate service and charges. 47 U.S.C. § 201. FCC regulation deals, of necessity, more with technical, short-term and limited questions than with broad, long-term, general policy questions. The FCC primarily engages in, by statutory command, regulation, not policy planning or analysis.

The lack of any single agency with the responsibility and charter to establish U.S. international telecommunications policy results in fragmentation of policy. The Subcommittee has recognized this problem, at least in part, in Section 241 of S. 611 and Section 256 of S. 622. Existing government entities, each with a different and limited charter, each lacking a statutorily-mandated method to coordinate with each other, develop their own policy. These multiple policies are often inconsistent, contradictory, and fragmented. As a consequence, U.S. policy in the international arena is announced in many voices. Responsibility for articulation of and coordination of this policy is duplicative.

Today, the closest thing the United States has to an overall policy-making entity in international communications is the United States Preparatory Committee to the CCITT. The Preparatory Committee now exists pursuant to a charter from the State Department. It is an open forum, open to the participation of all interested entities. Like the CCITT itself, the Preparatory Committee is organized into Study Groups divided by different functions. The Study Groups focus on establishing U.S. policy for international facilities planning, standards, operations and services. The Preparatory Committee (and the Study Groups) develop and submit to the CCITT United States contributions to, policy for, and positions on issues to be considered by the CCITT.

This Preparatory Committee has functioned well, but it is not an adequate mechanism for the final development or enforcement of U.S. international telecommunications policy. There is still a need for a centralized, coordinating entity with broad statutory responsibility and Congressionally-mandated authority.

2. There is no central authority to negotiate the basic ground rules for international telecommunications services between the United States providers of such services and governmental telecommunication authorities of foreign nations

United States international telecommunications services are offered on a competitive basis by private organizations, that is, the United States international voice and record carriers. This is not true in the rest of the world, as is noted in Section 241 of S. 611. In foreign nations, domestic and international telecommunications activities are, in most cases, the sole province of government monopoly agencies or organizations. As a result, the pluralistic, non-governmental and competitive United States international telecommunications carriers must negotiate with government agencies, administrations or ministries of foreign nations—or their government-controlled monopoly carriers—to establish facilities and services for international telecommunications between their specific carrier companies and the foreign governments.

This anomalous international telecommunications negotiating posture presents two particularly serious problems. (1) The diverse and competitive U.S. international carriers can be whipsawed and disadvantaged in negotiations with foreign administrations. A foreign administration can select from among U.S. carriers the one offering the most advantageous proposal, or use the proposal of one to elicit a more advantageous proposal from another. The U.S. international carrier, however, has no alternative but to deal with the foreign administration and to offer terms acceptable to it in order to procure from the foreign administration approval of the desired facility or service. As a consequence, pricing often is more favorable to the interests of the foreign administration than to the interests of the U.S. international carrier. (2) Negotiations between U.S. international carriers and foreign administrations or carriers exclude participation by, and therefore appropriate consideration of the needs of, the users of international telecommunications facilities and services. The results of the negotiations may, therefore, be detrimental to or inadequate to fulfill the needs of users.

The negotiations between U.S. international carriers and foreign government entities occur without the prior establishment of basic policy discussions or agreements between the United States Government and the relevant foreign government authority. No conceptual ground rules are negotiated and agreed upon by the United States Government and the foreign government authority in regard to what

international telecommunications services should be available to be offered by U.S. (or foreign) carriers, what policies are applicable to these services, what penalties are to be imposed for violation of these agreed-upon policies. There is no way to assure reciprocal treatment of U.S. international carriers by the foreign government. In short, U.S. policy becomes the result of bargains reached by parties with unequal bargaining strength (the foreign government and the U.S. international carrier). U.S. companies are disadvantaged by having policy parameters set not by the U.S. government, but rather by a foreign government.

- 3. There is no mechanism to enforce U.S. policy in the international field when there are difficulties with a foreign government or a foreign government-controlled carrier*

Should a foreign government take positions (either in international forums or in private negotiations with United States international carriers) that do not comport with international requirements and standards or with U.S. policy or regulatory requirements, there is no central government entity in the United States with authority to take action to resolve such difficulties. Similarly, users, excluded from negotiations between U.S. international carriers and foreign governments, have no U.S. government entity to represent their position, should negotiations break down, or result in agreements which do not fulfill user needs.

The Federal Communications Commission cannot fulfill these roles. It has jurisdiction over the U.S. international carriers. But it does not have jurisdiction over foreign governments or carriers, nor the authority to negotiate with them. To enforce U.S. policy, the FCC must depend on its jurisdiction over and ability to regulate the U.S. half of an international telecommunications circuit. This is simply not adequate.

- 4. There is no government entity with authority to analyze user requirements and formulate and advocate the development of the types of international services needed by U.S. users*

End users of international telecommunications services cannot control their fates. Rather, important decisions on services are left to the U.S. voice and international record carriers, who in most cases determine whether a certain service can and should be available to the user. Although the U.S. international carriers may consider a given service to be of value to the United States user company, the carrier may be very reluctant to place a service in effect due to the need to negotiate for it with foreign government or foreign government-controlled carrier. A U.S. carrier may fear that pressing with a foreign administration points of primary interest to a United States user of international service may cause the carrier to lose out to a competitor that is less aggressive in pursuing the user's interest.

U.S. carriers wishing to offer international service are at the mercy of foreign government-controlled telecommunications organizations; U.S. users are at the mercy of the U.S. carriers.

B. SUGGESTIONS

Control Data believes that this awkward and cumbersome situation can be rectified by the formation of a single United States government agency that would: (1) have the exclusive authority to establish United States international telecommunications policy; (2) have the power to negotiate with its counterparts in—and the international carriers of—foreign countries, and (3) have the power to enforce international telecommunications policies on behalf of the United States and its carriers and users.

S. 622 contains some measures to improve the United States posture in the international telecommunications arena, and Control Data applauds this effort. S. 622, however, in Sections 202 and 226, appears to focus primarily on the establishment of international telecommunications facilities. The bill contains no provisions that focus directly on international telecommunications service, nor on international telecommunications users. S. 611 also contains measures designed to improve the U.S. posture, but these measures similarly focus on facilities planning (Sections 240 to 253), rather than on the services provided over these facilities or the needs of the users of them. As noted above, Control Data believes consideration of services provided over and user needs for international telecommunications facilities is a critical element for successful U.S. participation in the international telecommunications arena.

S. 611 does establish part of the mechanism, an International Facilities Management Corporation, to deal with facilities planning, construction and operations. Facilities planning is, self-evidently, a basic prerequisite of future provision of international telecommunications service. The bill still leaves undecided, however, the mechanism for establishing the policy pursuant to which such facilities will be constructed and operated in offering international telecommunications services by U.S. carriers. S. 622 requires the Federal Communications Commission to develop a United States International Telecommunications Facilities Plan. Although one goal of the bill is the improved coordination of U.S. international telecommunications policy and foreign policy, the bill does not provide for service and use planning in this connection. See Section 256.

It is imperative that the United States have good, ongoing relations and policies with foreign telecommunications monopolies—government administrations and government-controlled carriers—for the establishment of international telecommunications facilities. It is equally important that policy be established to guide the development of the operations, standards and services provided on the basic international telecommunications facilities. Further, it is critical that the user community have an opportunity to participate in the formulation of those policies, because users must utilize the services offered over such facilities, pay for the use of the facilities, and abide by the policies under which the facilities were established.

Control Data believes that many of the problems discussed in this statement can be ameliorated. Control Data proposes the establishment of an Agency for International Telecommunications Policies (AITP, or the Agency) designated as an agency of the Department of State and reporting to the Secretary of State. The Agency would have exclusive responsibility for the development, coordination, implementation and enforcement of international telecommunications policy for the United States.

The Agency would be headed by a Director, appointed by the President, with the advice and consent of the Congress. It would have a Deputy Director, similarly selected.

The Agency would be able to draw on the international expertise, background and knowledge of the State Department. It would speak, in the international forum, with the benefit of the input from that Department's support services and with its international prestige. It would eliminate the need for cumbersome policy coordination with the Department of State by replacing the current Office of International Communications Policy. The Agency would be part of the Executive Branch entity (the Department of State) already responsible for the establishment and execution of U.S. policy in international relations and foreign affairs. Further, the Agency could represent U.S. policy interests in the sphere of foreign telecommunications while permitting the maintenance of the domestic policy of full and fair competition.

AITP's Director would have over-all and exclusive responsibility for the development of United States participation in international telecommunications matters and for enforcement of U.S. international telecommunications policy. The Director would directly or indirectly appoint and accredit U.S. delegations to international organizations concerned with telecommunications. The Director would also act as a Government representative in connection with Comsat matters and as a Government representative in connection with Intelsat and Inmarsat matters.

Control Data further proposes that the Agency have three functional bureaus:

1. Policy planning bureau

This bureau would be responsible for the overall development and maintenance of international telecommunications policies, including preparation for the United States participation in and formulation of policy in regard to international telecommunications organizations such as the CCITT, CCIR or WARC. The bureau would perform many of the functions described in Section 244(a) of S. 611 and in Section 226(a) of S. 622. The bureau would be assisted in performing its responsibilities by the resources of, and the input from, a United States Preparatory Organization, discussed below.

2. Facilities planning bureau

This bureau would be responsible for facilities planning functions. The bureau would perform those functions covered in Sections 244 to 246 of S. 611 and in Section 226(c) of S. 622. In addition, it would perform the functions now performed

by the International Facilities and Services Division, International Satellite Branch of the FCC.

3. International negotiations and enforcement bureau

This bureau would be responsible for negotiations between the United States and foreign telecommunications administrations, agencies or ministries involving basic policy issues. Further, this bureau would be responsible for the enforcement of U.S. international telecommunications policy. It would arbitrate with foreign administrations, and resolve specific complaints and problems of carriers and users.

A proposed organizational chart for the Agency is found as Attachment A to this statement.

Further, to aid the Agency in the creation and enforcement of international telecommunications policy, Control Data proposes the establishment, by statute, of a United States Preparatory Organization (USPO or the Preparatory Organization). The Preparatory Organization would be similar to the present U.S. Preparatory Committee for the CCITT.

The Preparatory Committee for the CCITT exists only under a charter from the Department of State. But its functions are critical and should therefore be established by statute. The Preparatory Committee enables users, carriers and others with vital interests in international telecommunications policy to raise issues, exchange information, develop an input to policy. It enables the Government to take advantage of tremendous expertise and experience available in the private sector, recognized in S. 611 in Section 243 and S. 622 in Section 226(g).

The new Preparatory Organization would continue these important functions. In addition, it would continue the Preparatory Committee Study Groups which parallel those of the CCITT, but would increase the number of such Study Groups from four to a maximum of one for each of the 30 existing CCITT Study Groups. These Study Groups would analyze and recommend U.S. policy in their functional areas, after receiving input from relevant government agencies.

The Preparatory Organization would assist the Director and the various Bureaus of the Agency in the formulation and development of U.S. international telecommunications policy. Its resources and activities would be coordinated with and complementary to those of the Agency's Bureaus. The Preparatory Organization, however, would draw on other than purely governmental resources, personnel and perspectives.

The Preparatory Organization would be headed by a Chairman, appointed by the Director of the Agency. The Chairman would also serve as the Chairman of the U.S. Delegation to the Administrative Council of the CCITT. The Chairman would accredit U.S. delegations to the CCITT and CCIR and to the study groups of these international organizations, and select the heads of such delegations and study groups. Members of the Executive Committee of the Preparatory Organization would chair the various study groups. The Executive Committee would be appointed by the Director of the Agency. The delegations, study groups and Executive Committee would include representatives of the government and the private sector, including users and carriers. See Section 226(g) of S. 622.

A proposed organization chart for the Preparatory Organization and its relationship to the Agency is found as Attachment B to this statement.

C. CONCLUSION

Creating institutional arrangements to centralize, coordinate and make credible U.S. international telecommunications policy is, of course, not simple. Control Data believes that establishment of an Agency and a Preparatory Organization, as proposed in this statement, are important steps in reaching this goal. If these steps are taken, the United States will participate in the telecommunications arena in a sensible and coordinated manner. The United States will have to deal with all aspects of international telecommunications with three strings to its bow: the Agency and Preparatory Organization with exclusive responsibility to develop and implement international telecommunications policy; the National Telecommunications Agency to develop and implement domestic telecommunications policy, and a Commission to assist in the technical, day-to-day, rates, allocations and regulatory aspects of both.

In a world where information is of increasing value, the availability and configuration of communications media is of paramount importance. In the international arena, if foreign nations have untrammelled control over the use and configuration

of communications media, U.S. carriers and users participation in foreign markets will also be controlled. Further, U.S. failure to establish coherent and forceful policy in this critical international area might be read by the rest of the world as a clear signal of U.S. intent to abdicate as world leader of the communications and information industries.

For these reasons, as well as for the reasons outlined in this statement, Control Data urges the creation, by statute, of AITP and the Preparatory Organization. To this end, Control Data has included, as Attachment C to this statement, proposed revisions to S. 611 and S. 622 which provide for the establishment of these two important components in the improvement of the U.S. posture in international telecommunications.

Should the Subcommittee wish, Control Data would be glad to provide further information in connection with this statement and the matters discussed in it.

ATTACHMENT A

DEPARTMENT OF
STATE

AGENCY FOR INTERNATIONAL
TELECOMMUNICATIONS
POLICIES

INTERNATIONAL
TELECOMMUNICATIONS
PREPARATORY
ORGANIZATION

STANDING AND AD
HOC U.S. DELE-
GATIONS TO INTER-
NATIONAL ORGANI-
ZATIONS

POLICY
PLANNING
BUREAU

FACILITIES
PLANNING
BUREAU

INTERNATIONAL
NEGOTIATIONS
AND ENFORCEMENT
BUREAU

STUDY STUDY STUDY STUDY STUDY
GROUP GROUP GROUP GROUP GROUP

STUDY STUDY STUDY STUDY STUDY
GROUP GROUP GROUP GROUP GROUP

ATTACHMENT B

DEPARTMENT OF
STATE

INTERNATIONAL
TELECOMMUNICATIONS
PREPARATORY
ORGANIZATION

CHAIRMAN

U.S. DELEGATION
TO THE ADMINISTRATIVE
COUNCIL CONSULTATIVE COM-
MITTEE ON INTERNATIONAL
TELEPHONE & TELEGRAPH (CCITT)

EXECUTIVE
COMMITTEE

U.S. DELEGATIONS TO
THE STUDY GROUPS OF
THE CCITT AND COMMITTEE
ON INTERNATIONAL RADIO
(CCIR)

UP TO 30
STUDY
GROUPS

U.S. DELEGATIONS TO
THE PLENARY CONFERENCES
OF THE CCITT AND CCIR

ATTACHMENT C

TITLE OO AGENCY FOR INTERNATIONAL TELECOMMUNICATIONS POLICY

FINDINGS

SEC. XXX. The Congress hereby finds that:

(1) many Government agencies with diverse mandates share responsibility for policymaking in the field of international telecommunications;

(2) as a result of such shared responsibility, there is little coordination in the policymaking efforts of various Government agencies;

(3) a fair and effective international telecommunications policy must take into account the needs of users as well as carriers, must deal with the international telecommunications services as well as facilities;

(4) the establishment of an independent Agency and a Preparatory Organization in the executive branch of the Federal Government, with exclusive responsibility for the development, coordination, implementation and enforcement of a uniform international telecommunications policy, would permit the people of the United States to take full advantage of advances in telecommunications technology; and

(5) the establishment of the Agency and Preparatory Organization within the Department of State will advance the foreign affairs and international telecommunications interests of the people of the United States.

DEFINITIONS

SEC. XXX. For purposes of this title:

(1) The term "Agency" means the Agency for International Telecommunications policy.

(2) The term "Director" means the Director of the Agency appointed under section XXX.

(3) The term "Deputy Director" means the Deputy Director of the Agency appointed under section XXX.

(4) The term "Preparatory Organization" means the United States Preparatory Organization.

(5) The term "Services" means the methods of communication presently or prospectively available through the use or employment of communications facilities, as defined in section XXX, through application of communications technology.

(6) The term "Users" means the present or potential intermediate or end consumers of communication services presently or prospectively provided by United States and foreign international voice and record carriers.

ESTABLISHMENT

SEC. XXX. There is hereby established an independent establishment in the Executive Branch of the Federal Government to be known as the Agency for International Telecommunications Policy (the Agency). The Agency is hereby established as a separate agency within the Department of State. The Agency shall have exclusive responsibility for the development, coordination, implementation and enforcement of the international telecommunications policy of the United States.

DIRECTOR AND ORGANIZATION AGENCY

SEC. XXX. (a) The head of the Agency shall be the Director, who shall be appointed by the President, by and with the advice and consent of the Senate. The Director shall report to the Secretary of the Department of State. The Director shall be paid at a rate not to exceed the rate of basic pay which is payable from time to time for level III of the Executive Schedule under section 5314 of title 5, United States Code.

(b) The Agency shall have a Deputy Director, who shall be appointed by the President, by and with the advice and consent of the Senate. The Deputy Director shall be paid at a rate not to exceed the rate of basic pay which is payable from time to time for level IV of the Executive Schedule under section 5315 of title 5, United States Code. The Deputy Director shall perform such duties and exercise such powers as the Director may prescribe. The Deputy Director shall act for, and exercise the powers of, the Director during any absence or disability of the Director or during any vacancy in the office of Director.

(c) The Director will organize the personnel of the Agency into the following three bureaus:

(1) Policy Planning Bureau;

(2) Facilities and Services Planning Bureau;

(3) International Negotiations and Enforcement Bureau;

(d) The Director shall act as a Government representative in connection with COMSAT matters and as a Government representative in connection with INTEL-SAT and INMARSAT matters.

(e) The Director will appoint the Chairman of the United States Preparatory Organization (the Chairman). The Preparatory Organization shall be part of the Agency. It shall assist the Director and the Bureaus of the Agency in the develop-

ment and formulation of United States international telecommunications policy. The Director will require the Chairman to establish:

- (1) An Executive Committee of the Preparatory Organization comprised of representatives of the Government and the private sector, which shall include representatives of U.S. international carriers and intermediate or end users of international telecommunications services.
- (2) Study Groups, each chaired by a member of the Executive Committee, paralleling in subject matter classification the study groups existing within the Consultative Committee on International Telephone and Telegraph (CCITT), and drawing upon the expertise available in the private sector, as well as the Government.
- (f) The Chairman shall also perform the following functions:
 - (1) serve as the Chairman of the United States Delegation to the Administrative Council of the International Telecommunications Union (ITU);
 - (2) appoint and accredit United States delegations, which shall be comprised of representatives of the Government and the private sector, which shall include representatives of U.S. international carriers and intermediate or end user, to the Plenary Conferences of the Consultative Committee on International Telephone and Telegraph (CCITT) and the Consultative Committee on International Radio (CCIR), and appoint the chairman of such delegations;
 - (3) appoint and accredit United States delegations, which shall be comprised of representatives of the Government and the private sector, which shall include representatives of U.S. international carriers and intermediate or end users, to the study groups of the CCITT and CCIR and appoint the chairmen of these study groups.
- (g) The Director shall appoint and accredit United States delegations, which shall be comprised of representatives of the Government and the private sector, which shall include representatives of U.S. international carriers and intermediate or end users, to such other international organizations, meetings, entities or associations concerned with international telecommunications as are determined by the Chairman, upon the recommendation of the Executive Committee, to require the representation of U.S. interests; and the Director shall appoint the chairman of any such United States delegations.
- (h) The Director shall establish, after notice and comment, such rules and regulations as are necessary to carry out the duties of the Agency.

FUNCTIONS

Sec. XXX. The Agency shall have exclusive responsibility to formulate, coordinate, implement, and enforce, United States international telecommunications policy. The Preparatory Organization shall assist the Director and the Bureaus, and its Chairman shall perform the duties specified in Section XXX of this Title. Each of the three functional Bureaus within the Agency will have the specific, articulated responsibilities enumerated in this section. Each Bureau may hold public hearings or may employ any other methods authorized by law, including subpoena, to gather information necessary to the performance of its functions.

- (1) The Policy Planning Bureau shall, acting through the Director:
 - (a) be responsible for the overall development and maintenance of international telecommunications policies;
 - (b) prepare for the United States participation in, and the formulation of policy in regard to, international telecommunications organizations; and
 - (c) coordinate and implement international telecommunications policy for the Executive Branch.
- (2) The Facilities & Services Planning Bureau shall, acting through the Director:

In regard to planning for facilities:

 - (a) collect and assemble information, including long-range and short-range projections of international telecommunications traffic, the facilities determined by the Bureau to be necessary for such traffic, and the projected capacity and cost of each such facility;
 - (b) develop specific procedures for coordinating the domestic facilities and services policymaking processes of the National Telecommunications Agency and other Government agencies to ensure that United States domestic and foreign policy and national security interests are represented in the process set forth under subparagraph (c) of this subsection;
 - (c) engage in long-range planning for the construction and implementation of all international telecommunications facilities in a manner designed to allow the owners of such facilities maximum flexibility in negotiating with their foreign correspondents, while at the same time resulting in minimum regulatory restrictions established by the United States;

(d) together with the Secretary of State and the Secretary of Defense, advise the President of foreign policy and national security considerations with respect to international telecommunications facilities;

(e) submit to the Commission¹ a report summarizing the activities of the Bureau and its recommendations with respect to each international telecommunications facility which is constructed after the effective date provided for in section XXX; and

(f) consult with the governments of foreign nations and foreign administrative agencies, ministries or administrations and foreign international voice and record carriers with respect to international telecommunications facilities matters.

In regard to facility construction

(a) permit the Corporation² or any carrier to construct or acquire any international telecommunications facility—

(i) before the conclusion of any business negotiations with a foreign nation, a foreign administration, foreign telecommunications carrier, or an international organization with respect to construction or acquisition of such facility, if the Corporation or each such carrier, as the case may be, notifies the Bureau and the Commission;

(ii) the President, not later than 90 days after such notification has been received, does not disapprove such construction or acquisition for reasons of foreign policy or national security, or both; and

(iii) the Corporation or each such carrier is authorized by the Commission to enter into agreements with foreign nations or administrations or carriers which, together with the Corporation or such carrier, propose to construct or acquire such facility and operate and offer services through such facility. During any such business negotiations, the Corporation or any such United States carrier shall inform the Secretary of State with respect to matters contained in such negotiations which relate to the purpose of this title. The Secretary of State and the Director of the Agency, or his designated agent, shall render such assistance to the Corporation or such carriers as may be appropriate.

(b) Before the implementation of any newly constructed international telecommunications facility, the Corporation or each carrier, as the case may be, shall notify the Commission and the Bureau of:

(i) the cost of such facility to the Corporation or carrier;

(ii) the total circuit capacity of such facility;

(iii) the estimate of circuit utilization in such facility for each year of the projected useful life of such facility; and

(iv) such other information as the Commission or Bureau, respectively, may require.

In regard to planning for services

(a) collect and assemble information regarding the short-range and long-range needs of communication services intermediate or end users;

(b) develop specific procedures for accommodating for the needs of users, as determined by the process set forth in paragraph (a), in the short-range and long-range planning for the construction and implementation of international telecommunications facilities;

(c) submit to the Commission a report summarizing the activities of the Bureau and its recommendations with respect to the needs of international telecommunications users;

(d) consult with foreign nations and administrations and foreign international voice or record carriers with respect to international telecommunications services matters and the needs of the users of these services.

In regard to satellite facilities

(1) insure effective competition, including the use of competitive bidding where appropriate, in the procurement by the Corporation and communications carriers of apparatus, equipment, and services required for the establishment and operation of the communications satellite system and satellite terminal stations; and the Bureau shall consult with the Small Business Administration

¹ The Commission refers to the Federal Communications Commission established in Section 101 of S. 611 and/or the existing Federal Communications Commission which is left substantially as it is now by S. 622.

² The Corporation refers to the Communications Satellite Corporation (COMSAT) established by the Communications Satellite Act of 1962, 76 Stat. 419, 47 U.S.C. §§ 701-704.

and solicit its recommendations on measures and procedures which will insure that small business concerns are given an equitable opportunity to share in the procurement program of the Corporation for property and services, including but not limited to research, development, construction, maintenance, and repair;

(2) insure that all present and future authorized carriers shall have nondiscriminatory use of, and equitable access to, the communications satellite system and satellite terminal stations under just and reasonable charges, classifications, practices, regulations, and other terms and conditions;

(3) in any case where the Secretary of State, after obtaining the advice of the Bureau as to technical feasibility, has advised that commercial communication to a particular foreign point by means of the communications satellite system and satellite terminal stations should be established in the national interest, institute forthwith appropriate proceedings under Section XXX of this Act to require the establishment of such communication by the Corporation and the appropriate carrier or carriers;

(4) insure that facilities of the communications satellite system and satellite terminal stations are technically compatible and interconnected operationally with each other and with existing communications facilities;

(5) exercise oversight of the approval of technical characteristics of the operational communications satellite system to be employed by the Corporation and of the satellite terminal stations;

(6) may comment on, recommend grant or denial of, requests to the Commission for authorizations for the construction and operation of each satellite terminal station, either by the corporation or one or more authorized carriers or by the Corporation and one or more such carriers jointly;

(7) insure that no substantial additions are made by the Corporation or carriers with respect to facilities of the system or satellite terminal stations unless such additions are determined to be in the interest of the United States;

(8) require, in accordance with the procedural requirements of Section XXX of this Act, that additions be made by the Corporation or carriers with respect to facilities of the system or satellite terminal stations where such additions have been determined to be in the interest of the United States.

(3) The International Negotiations and Enforcement Bureau shall, acting through the Director:

(a) be responsible for negotiations in connection with basic policy issues and questions between the United States and foreign telecommunications administrations, agencies, or ministries;

(b) be responsible for the enforcement of U.S. international telecommunications policy;

(c) arbitrate with foreign governments, ministries, agencies or administrations or foreign international voice carriers and resolve specific complaints and problems of United States international carriers intermediate or end users of international telecommunications services.

(4) The United States Preparatory Organization shall, acting through the Director:

(a) Promote the best interest of the United States in CCITT and CCIR and other international telecommunications organizations (ITOs) activities;

(b) Provide advice on matters of policy and positions in preparation of CCITT and CCIR Plenary Assemblies and ITO meetings and meetings of the international CCITT or ITO Study Groups;

(c) Provide advice on the disposition of proposed contributions (documents) to the international CCITT or ITOs;

(d) Assist in the resolution of administrative/procedural problems pertaining to United States CCITT, CCIR or ITO activities;

(e) Provide such assistance and information as may be required and appropriate to the Director and to the Bureaus specified in Section XXX of this Title;

(f) The Study Groups established by the Director shall:

(1) receive and collect information from and the views of, relevant government agencies and interested members of the private sector and general public, after which they shall,

(2) analyze and set forth U.S. positions in each of their respective functional areas, and

(3) report information and recommend policy to the Executive Committee, the Chairman and the Director.

Senator GOLDWATER. Thank you very much, Mr. Onstad.

We know that you are pressed for time, and we appreciate your coming down. We did not have time to review your statement, so we do not have any questions.

The international aspect of this legislation will be coming up later, so if you want to submit any further comments or add to what you have said, you can do so.

I have just one question. S. 622 provides for private representation on U.S. delegations to international conferences. Would you be in favor of that?

Mr. ONSTAD. I would like, Mr. Chairman, to consider two aspects of the international communications area. One is the aspect of the communications facility itself and the other is the carrier, the private enterprise handling of it. I think that the latter has been somewhat successful at the present time because private enterprise is handling it.

There is, however, some feeling on the part of foreign administrations—and we get into this subject, for instance, at the CCITT, that when a foreign communications entity is government-owned, dealing with multiple private entities within the United States, there is difficulty in having to deal with more than one body in the United States, in the actual communications area.

Certainly I think that we need to make it clear in any legislation that we are talking about two different things. One is facilities and their actual construction, and the other is offering of services, which certainly is today and probably will continue to be in the private enterprise area.

The U.S. policymaking decisions, the standards, the basic policies in negotiations in telecommunications on a worldwide basis, I think, will also have to be made by Government and within Government, because work on the other end of international telecommunications links is with a foreign government.

In the case of the United States, there is a private enterprise involved, but it is probably the only place in the world that there is truly private enterprise in the offering of international telecommunications services. In France, for example, international telecommunications services are operated through the French Postal and Telegraph ministry.

For these reasons, we need a strong governmental force to lay the basic ground rules for establishing basic policies on how the United States communicates with foreign countries for example, on matters of transport of data, what type of information can be passed back and forth across international boundaries.

I would like to give you an example of why such an approach is needed, involving a current problem in Japan. I just came back from Japan. In Japan, the telephone company, which is government-owned, also engages in data processing service and competes with our company and several other American companies.

The Japanese have now placed a restriction on the amount of data that can be transmitted from Japan back to the United States over a satellite channel. In essence, that channel must terminate in only a single computer in the United States.

Our products are offered on a number of computers in the United States. Because of this restriction on international telecom-

munications, we can sell in Japan only products on a very specific computer in the United States. These telecommunications restrictions create a trade barrier for us in Japan, which furthers the interests of the Japanese telephone company in competing with us in the area of data processing services.

This is the type of problem which must be settled on a government level. It is almost impossible to handle such conflicts when one participant is a private party and the other participant is a government body. In using a private enterprise approach, you would be trying to resolve these difficult types of questions.

Senator GOLDWATER. I would feel much safer if we had private enterprise representatives on these delegations. The average representative on a government body is chosen to pay off a little political debt, not because of particular technical expertise. I know a little bit about these international problems, because I deal with frequencies that are controlled by the ITU. We have been losing our shirt, because we have not had enough people on our U.S. delegations engaged in the day-to-day business of using frequencies.

Mr. ONSTAD. I understand.

Senator GOLDWATER. I will certainly make note of what you have said and suggested.

The intent of S. 622 was to provide private enterprise representation on Government delegations. I think in this field it is almost necessary.

Mr. ONSTAD. Yes. And today I think that the CCITT, may provide the United States a rather workable structure to do this. We have an American preparatory group to the CCITT made up of carriers, users, manufacturers, Government individuals. We establish a U.S. policy within that group, which is then approved by the State Department and the FCC and others.

We then take a delegation to Geneva, and that is where I am leaving for now, the only delegation in the entire international body made up of users as well as carriers and Government individuals—to express a U.S. point of view. I do not want to see that lost.

I think that the structure of U.S. international telecommunications policymaking is critical to this country and should be reviewed and even more strongly strengthened. And I would like to offer further suggestions in that particular area, in my additional comments to you.

Senator GOLDWATER. Thank you very much. Knowing of your time limitation—which I am working under, too—we will excuse you. Thank you very much for coming.

Not because you other gentlemen are in any particular order, you just happened to sit that way—the only time I recognize the left is from left to right.

So you are next Mr. Leghorn.

STATEMENT OF RICHARD S. LEGHORN, PRESIDENT, CAPE COD CABLEVISION CORP.

Mr. LEGHORN. Thank you very much, Mr. Chairman.

My name is Richard S. Leghorn. I am president and owner of Cape Cod Cablevision Corp., South Yarmouth, Mass., which serves more than 22,000 single-family residences with 12 channels of television programing.

In the few minutes allotted, I will sketch a perception of our industry's role significantly different from the conventional, but one which I believe should substantially influence forward-looking legislation for the governance of our industry.

Today our industry is generally referred to as "cable television," and its members are called "cable operators." Both these terms are fast becoming misnomers, and they have confused legislative planning. A general fascination with the potentials and problems of broad-band facilities has obscured the true nature of our business.

Our industry is not in the cable facilities business. Our primary economic function is that of publisher and editor; we deliver to our subscribers a composite signal of video materials selected from an expanding number and variety of sources, especially satellite sources. Because we use telecommunications facilities to distribute our electronic publication, I will refer to the nature of our business as "multichannel telepublishing" to distinguish it from single-channel broadcast and nonbroadcast programming.

Using editorial discretion in the interests of our subscribers, we gather, select and assemble these channels and other video and informational materials into a broad-band signal. We distribute the resulting "telepublication" to our subscribers via cable facilities. Gathering, selection, assembly, and distribution constitute the essence of publishing. That is what we do.

We are not carriers. Carriers transmit intelligence indiscriminately for one and all, without regard to content. As communicators they function at an extreme from publishers. Carriers are complete noneditors. Publishers employ editorial discretion to select, assemble and distribute to subscribing customers for whom they design their publication.

Today, throughout our industry we build and own our distribution plant. In the 1960's some of us tried leasing our plant from carriers. For example, on Cape Cod our first 75 miles of distribution plant were built and owned by New England Telephone, who leased to us.

But as an industry we early learned that, given today's economic circumstances revolving around analogue, coaxial distribution technology, it is far better in terms of cost, service, and quality for us to build and operate our own distribution plant than to lease from carriers, just as daily newspapers own the presses they use.

Some speculate that in a future of digital transmission and optical technologies, our industry, as a matter of economic choice, might again turn to leasing carrier facilities—to buy rather than make, as manufacturers would say. But whether we own or lease our distribution plant, we will remain publishers and not carriers.

If this perception of our role is valid, what are the implications for telecommunications policy? Dominant considerations would seem to revolve around the first amendment to the Constitution. Let me suggest three areas for concern.

First, a strong case can be made, I believe, against Government intrusion upon, or abridgment of the first amendment rights of cable television functioning as telepublisher. I refer to matters of rate regulation, franchise fees, carrier-type access, and particularly to the very existence of government licensing authority over an electronic press.

These matters are now left largely to State and local jurisdictions. However, in revising communication law, Congress could obviate much litigation and constitutional challenge if, after thorough study and debate, it would reflect in the new law the first amendment rights of cable television functioning as telepublisher.

Government intrusion of just this sort at State and local levels is today preventing expansion of Cape Code Cablevision beyond its 12-channel capacity. It is impeding Cape Cod's ability to grow as it could have, had it been free to act as a publisher independent of the stifling authority of Government licensors.

A second area of concern is the right of our subscribers to indirectly receive broadcasts initially distributed via the publicly owned spectrum. What is the difference in the rights of a viewing member of the public who chooses to receive a publicly licensed television channel directly off-air and the rights of another who chooses to receive that publicly licensed channel indirectly via his publisher? Are not both equally entitled to access, without Government interference, to video materials distributed openly via the electromagnetic spectrum?

The goals of communications policy should not be confused with those of copyright policy. Subscribers, as a matter of communications law, should have first amendment rights to receive television materials distributed openly via the spectrum—to say nothing of their rights in equity as collective owners of the spectrum.

An entirely separate question is just compensation to copyright holders. A compulsory license for compensating copyright owners for cable television transmissions was mandated in the 1976 Copyright Law, along with provisions for review of payments by a Copyright Tribunal. Whether this compulsory license will continue to be judged the best solution to the copyright problem is a separable question, addressable once communications policy derived from the first amendment is laid down relative to the public's right of access, directly or indirectly, to broadcast channels.

It would hardly seem that the relative merits of this or that readjustment in the method or amount of copyright payments should be allowed to delay or confuse recognition of the first amendment rights of viewers to receive television broadcasts directly or indirectly as they may choose.

Third, there is a public policy issue whether under any circumstances telecarriers should be permitted to be telepublishers, or vice versa. In the sense of the first amendment, common carriage is antithetical to publishing. Would such commingling of functions give rise to a weakening of the first amendment? Would the rights of independent publishers of access to telecarrier facilities be diminished if monopoly carriers themselves are permitted to publish entertainment, information, and opinion?

And could significant public good arise from telecarriers functioning as telepublishers, which would outweigh the potential harm to our first amendment heritage? If telecarriers can provide facilities at market justifiable rates, then surely independent publishers will step forward to utilize these facilities.

Permitting carriers to offer data services as proposed for the revised law is one thing. But permitting telecarriers to function as telepublishers is something else. Why authorize monopoly carriers

to engage in telepublishing and thus risk anticompetitive abuse which would be tantamount to suppression of speech?

In summary, during the debates preceding enactment of the 1934 Act, considerable attention was devoted to first amendment considerations. Surely in revising this act, today's debates should focus critical attention on three areas of first amendment concern:

One, the role of the cable television industry as multichannel telepublisher, with its attendant first amendment rights, particularly against the encroachments of Government licensors, special franchise fees, price regulation, and the imposition of carrier-type access obligations;

Two, the first amendment rights of the viewing public to receive materials either directly or indirectly which are first transmitted openly over the publicly licensed spectrum;

And three, the potential harm to the role of the first amendment if telecarriers under any circumstances are permitted to function as telepublishers.

In recent years, the courts, as in the *Midwest Video* and *HBO* cases, have begun to recognize the characteristics of cable television as publisher. Now the time has come for Congress to fit cable television as telepublisher into the Nation's telecommunications structure.

The first amendment has been called the cornerstone of our democracy. And the concern of the first amendment clearly is communications—the right to speak and the right to hear. Yet in the statement of purposes of all the communications bills now before Congress—S. 611, S. 622, and H.R. 3333—there is not one word about the first amendment and the ever-present imperative to protect and nurture its role in our society. Hopefully, debate on these bills will bring the first amendment back to center stage to stand ahead even of vital economic issues as deregulation and competition.

Mr. Chairman, thank you for the privilege of testifying about this matter of constitutional concern.

Senator GOLDWATER. You brought up some very interesting questions that we will want to know more about.

Cable television, in my part of the country, is very, very important. When we get into the mountain areas like the far Rocky Mountains of the West, there is no way to operate except with reflectors. We have many areas where they cannot be used because of geography and because of cost. So we rely on cable.

The question on cable to just what you brought up, the cable facilities owners versus the cable program provider. We are going to give this a lot of thought.

We will ask some questions, when all of you have finished.

Mr. Bresnan, of Teleprompter Corp., I believe, is the next witness.

STATEMENT OF WILLIAM J. BRESNAN, PRESIDENT, CABLE DIVISION, TELEPROMPTER CORP.

Mr. BRESNAN. Good afternoon, Senator Goldwater.

I am William J. Bresnan, president of the Cable Television Division of Teleprompter Corp.

My purpose here today is to urge this committee not to allow our television industry—a crucial part of the Nation's communication system—to be controlled by a giant monopoly. The prospect of monopoly domination is not some imaginary horror, but the inevitable result of allowing telephone companies into the cable television business.

Let's consider for a moment what this kind of monopoly would mean to society. For years people—Congressmen, FCC Commissioners and just plain viewers—have complained about the fact that television is dominated by three networks. Three men ultimately determine what almost everyone in America watches on his television set. Three men ultimately determine what kind of entertainment and what kind of news coverage we see.

Allowing the phone company to get into the software business—selecting, producing and marketing its own programming—will mean that the cable television industry and ultimately the broadcast industry will be swallowed up by the phone company monopoly. Instead of three men making decisions as to what we see on television, only one man will ultimately make those decisions—the head of the phone company.

Moreover, a phone company monopoly over television will entail great economic as well as social costs. Consumers will pay more for the monopoly services, not less. And they will receive less imaginative programming from the monopoly than they would otherwise. Reduced services at higher prices is what always results from a monopoly, no matter how stringently regulated.

Why are we so sure that allowing the phone companies into the cable business would necessarily result in the massive monopoly that I have just discussed? For two reasons:

First, a monopoly—and the phone company is the monopoly in this country—regards competition the way nature regards a vacuum: It abhors it. The inherent thrust of any monopoly is to expand from its monopoly base to crush competition.

Second, there is our experience with the phone company. This experience—representative examples of which are attached to my written testimony—has convinced every single member of the cable industry that the phone company will, unless restrained, do everything in its power to take over the cable business.

And we are not the only ones who are convinced: The FCC, after conducting an exhaustive inquiry on telephone company predatory practices, flatly banned the phone companies from the cable business in their service areas. Also, the Justice Department in its recent "Offer of Proof" in its antitrust case against A.T. & T. devotes 35 printed pages to summarizing A.T. & T.'s attempt to take over the cable business. Attached to my written testimony are copies of the FCC "Report and Order" and Justice Department "Offer of Proof." I urge each of you to read these documents because I believe they will convince you that the phone companies are unfair and ruthless competitors who seek, in the words of one internal Bell memorandum quoted by the Department of Justice, "ownership of all communications distributions facilities."

S. 622 recognizes the threat to free competition and media diversity posed by telephone company entry into the cable business. It

flatly prohibits, except in certain rural areas, telephone company entry into the cable television business.

Note, however, that S. 622 does not attempt to legislate against technology. It allows the phone companies to build broadband systems and lease capacity on their systems to third parties (some of whom could be competitors of the local cable company). Thus, S. 622 preserves a free marketplace without denying consumers the benefits that advanced technology may bring. We wholeheartedly support S. 622's treatment of this crucial issue.

S. 611 also recognizes the threat posed by telephone company entry into the cable television business. But its treatment of this problem is somewhat ambiguous and is, therefore, in our judgment, unsatisfactory. Specifically, S. 611 contemplates that the FCC may allow telephone companies to provide cable television service under conditions which, in the words of the bill, are adequate to achieve separation of cable television services from noncompetitive telecommunications services. I suggest to you that no such conditions are possible and that there is, therefore, no way to protect society against predatory telephone practices.

Even if the telephone company's cable television activities are conducted by a separate subsidiary, the employees of that separate subsidiary would still consider themselves employees of the telephone company. These men would undoubtedly do just what the phone company told them to do. This is the universal experience with separate subsidiaries.

For example, Teleprompter's cable television division, of which I am president, operates through separate subsidiaries in some areas. But if we make a decision in New York, I expect to see that decision carried out at the local system level—whether or not the system is operated by a separate subsidiary. And if the head of any separate subsidiary were unable or unwilling to carry out company policy, we would get a new president for the subsidiary.

Similarly, if the phone company should decide that its cable subsidiary should operate at a loss or at below-market rates of return in order to drive out competition, you can be sure that is how the Bell Cable Co. would operate. And because there is no limit on the ability of the phone company to use its monopoly profits from its local distribution plant to subsidize the activities of the Bell Cable Co., there is nothing to stop the telephone company from proceeding in exactly this manner.

It is interesting to note that in most cases of telephone company anticompetitive conduct the telephone company acted through a separate subsidiary. Some of this conduct was incredibly blatant. Once again, I refer you to the attachments to my written testimony, the extensive "Report and Order" issued by the FCC, the 35-page excerpt from the Justice Department brief, and the list of examples of telco abuses. The catalog of horrors contained in these documents are not imaginary horrors. They actually happened, and they happened to me and to other people like me in the cable television business.

And, as I said, in many of these cases the telephone company used so-called separate subsidiaries to commit these abuses.

For example, the phone companies would deny pole attachments to independent cable operators while at the same time granting

such attachments to their own subsidiaries. Or the phone companies would engage in the sort of cross-subsidization that I mentioned a moment ago. They would demand an exorbitant price for pole attachments—a price that the independent cable company could not afford but which, of course, did not deter the phone companies' cable subsidiaries. Once again, the result was that phone company subsidiaries monopolized the market.

I recognize that most of the past phone company abuses regarding the cable industry have involved pole attachment practices and that S. 611 contains a provision designed to remedy the pole attachment problem. But the sordid pole attachment history is only indicative of the phone companies' monopolistic intent. By simply allowing their affiliated cable companies to operate at a loss—while being subsidized by their own monopoly profits—the phone companies will achieve the same monopolistic goal as by the cruder method of denying pole attachments in the first place.

One further aspect of the history of the phone company entry into the cable business bears mentioning. When the FCC adopted its cross-ownership rules, it did not ban all telephone company entry into the cable business. The prohibition extended only to the phone companies' service areas. Outside of these areas, the phone companies were free to compete with the independent cable operators. But none did.

Once denied the advantage of a local telephone monopoly, no phone company was willing to take up the challenge to meet the cable operators in a fair fight. This says something about the kind of competition the phone company wants.

But it also says something about the cable industry. If there is any message I want to leave with you, it is this: The cable industry is not afraid of competition. In a fair fight, we can hold our own with anybody. We have survived and prospered against great odds—ranging from the protectionist rules of the FCC to the predatory practices of the phone companies. And we are accustomed to competition. We have lived every day of our existence in a highly competitive marketplace. Cable television competes with television stations, movie theaters, MDS systems, STV and new video tape and disc suppliers.

Nor do we fear any technology. Specifically, we seek no protection from any one-wire plant which the phone companies or others may develop. If it turns out that such a one-wire plant is cheaper than our present dual system, then we will take our chances as packagers and marketers of programing on such a system in competition with any other similarly franchised competitor.

But, as I have said before, allowing the phone company to own both the hardware and software is to invite cross-subsidization and predatory practices which will surely drive out competition and deliver the entire television industry into the hands of the monopolist.

In closing, let me return for a moment to S. 611. It is clear that the drafters of the bill were concerned about the matters I have discussed, and they attempted to protect against them, although, as I have said, I believe that the protections contemplated by section 227 are not adequate. In section 265 of the bill, however, the drafters have established a sound procedure for permitting tele-

phone company entry into the cable television business. In that section, which deals with rural telecommunications, the FCC is instructed to permit telephone companies entry only after considering the benefits derived from diversity of ownership and, most importantly, only in cases where diversity of programming would not otherwise be available.

If this requirement is appropriate to rural areas, is it not even more appropriate to the rest of America, where the financial stakes are so much greater and where there is a correspondingly greater incentive for the phone companies to engage in anticompetitive conduct?

We were heartened, Mr. Chairman, when introducing this bill, you stated, as does section 265, that phone companies would be allowed into the television business only when no other means of service was available. We urge this committee to return to this salutary principle.

Thank you.

Senator GOLDWATER. Thank you very much.

I must say that this particular part of the telephone company's services has given a lot of us cause for concern. That is why we put the language in S. 622.

I think you would be interested to learn, if you do not already know it, that in the hearings yesterday before the House subcommittee Charles Brown, chairman of A.T. & T., said that A.T. & T. would accept statutory language prohibiting A.T. & T. from offering cable TV programming and pay TV services.

Mr. BRESNAN. I heard that, Senator.

Senator GOLDWATER. He indicated that to me, when I brought up the problem of their bare-wire television service which they have available. They agreed that the statutory prohibition would be all right with them.

Do you think it would satisfy your concern?

Mr. BRESNAN. If we could get a statutory prohibition that would not only keep A.T. & T. out, but also keep the independent telephone companies out of the business, that would be a great step forward.

Many of the abuses, Senator, that I referred to have been committed by some of the independent telephone companies.

Senator GOLDWATER. Would you be willing to accept a waiver for smaller telephone companies, such as we have throughout the West?

Mr. BRESNAN. In rural areas, the type of waiver that is contemplated in the bill now, which provides a waiver in the rural areas where there would be no other means of service available, I would say that that would be in order. I do think that when you grant such a waiver, you are making a tradeoff. When you let the telephone company, large or small, into the programming business, there is a risk involved. But I think there is a tradeoff in the rural areas. If service could not be provided in any other way, then perhaps the benefit is worth the risk.

Senator GOLDWATER. I will throw out a quick example, because I do not want to be too long.

We have an Indian tribe, the White Mountain Apaches, that want to put in cable television, but no cable television company can

see any profit because of the distance that would be required. But there is a telephone company that services them.

This is an example of where a small telephone company might be allowed to use the bare wire concept and pick up from cable at a nearby cable outlet. So we have got to consider all these things.

But I am very glad you brought that out, and I am glad to tell you that we brought this up with A.T. & T., not once, but several times—and not just your end of cable television, but the other side, that I have talked about earlier.

Mr. BRESNAN. Yes, sir.

[The attachments referred to follow:]

EXAMPLES OF TELEPHONE COMPANY ABUSE—REPORT

The FCC originally entered the area of telco/cable regulation in 1966, when the telcos were directed to file tariffs in order to provide local coaxial cable distribution facilities to cable television operators. Common Carrier Tariffs for CATV Systems, 4FCC 2d 257.

Two years later, the FCC determined that 214(a) authority had to be obtained by a telco before it could construct, acquire or operate distribution facilities to provide channel service to a cable television system. *General Telephone Co. of California*, 13 FCC 2d 488, aff'd, *General Telephone Co. of California v. FCC*, 413 F.2d 390 (D.C. Cir. 1969, cert. denied U.S. 88 (1969)).

The 214 applications filed by the telco as a result of the above ruling were analyzed by the FCC and many were found to contain evidence of ownership affiliations between the telco and the cable company. Questioning the legality of this affiliation situation, the FCC instituted Docket 18509 to determine if telcos, either directly or indirectly, should be permitted to supply cable service.

Throughout the proceeding it was demonstrated that local telephone companies were generally able to pre-empt effectively the cable television market, and to extend, without need or justification, their monopoly control over new broadband services. Final Report and Order in Docket 18509, 21 FCC 2d 307, 323 (1970). This extension of monopoly control was accomplished in several ways.

1. Telephone companies abused their entrenched monopoly position and their long established political relationships to convince local officials to award cable television franchises only to the local telephone company subsidiary.

For example, in 1965, United Utilities, a separate subsidiary of United Telephone Co., adopted a policy designed to prevent cable franchisees from being granted to an unaffiliated company in any community served by United. To implement this policy, United's managers were encouraged to actively seek franchises for their respective areas.

One such manager applied for a franchise in Warrensburg, Missouri, where he had served on the city council. Several letters were sent by United to local officials "reminding" them of all the favors the telephone company had done for the community. Even after a franchise had been granted to an independent operator, United pressed its application. In a public franchise hearing, the telephone company manager stated that the unaffiliated cable operator would be allowed to attach to United's poles. Later, in a private call to the Mayor, this promise was revoked. United was ultimately awarded a second franchise. See *Warrensburg Cable, Inc.* 48 FCC 2d 910 (1973).

Similarly, in *Telecable Corporation*, 19 FCC 2d 574 (1969), the Commission found that the General Telephone affiliated companies used their monopoly position to convince the city council not to award the franchise to an independent cable company. Furthermore, Pacific Northwest Bell intervened with the governing authority of the city of Portland, Oregon in 1974 to deter the award of a cable TV franchise which might offer competitive services. Pacific Northwest Bell argued that the cable system would be superfluous and would violate the telephone company's charter as the sole provider of communications services. In addition, Pacific Northwest Bell threatened that implementation of the planned system would increase telephone rates and jeopardize the re-election of council members who supported the plan.

2. Telephone companies advised local franchising officials that independent cable operators would not be granted access to poles even if a franchise was not awarded to the telephone company subsidiary.

Illustrative of this practice is the November 19, 1965 letter from Mr. George J. Wickard, CATV Coordinator, United Telephone Company of Pennsylvania, to the President of the Borough Council, Borough of Hanover, Pennsylvania.

"The United Telephone Company of Pennsylvania is preparing tariffs to provide and lease signal distribution facilities for community antenna television systems. Pole attachment agreements permitting CATV operators to attach to United Company poles will not be available to any CATV operator who should become successful in a bid for CATV franchise.

"United Utilities Incorporated, our system parent company, has formed a subsidiary company, United Transmission, Incorporated, which will provide and operate CATV systems. United Transmission has completed signal strength surveys and other feasibility studies for Hanover Borough. I have been authorized by United Transmission, Incorporated to request time on the Borough Council meeting agenda in order for United Transmission to present its proposal to provide Hanover Borough residents with community antenna television service . . ."

3. Telephone companies often commenced service in communities without local franchises on the theory that their certificates from the state PUC were sufficient.

This tactic allowed the telephone company to disregard any local determination as to the appropriate cable franchisee and simply commence operations in competition with established operators without complying with established local procedures. See, *Teleprompter Cable Systems, Inc. v. FCC* (Johnstown, PA), 543 F. 2d 1379 (D.C. Cir. 1976).

4. To advance their own cable effort, company-wide policies were adopted by the telephone company refusing to grant pole attachments to independent cable systems while granting such access to the telephone company's separate subsidiary.

For example, at a management meeting on December 15 and 16, 1964, United Utilities adopted a "CATV Policy Statement" which concluded, in part:

"We believe it is in the public interest that pole and duct line space be utilized as efficiently as possible, that each service carry its full share of cost, and that the control of this property be exercised by the public utilities (telephone and power) which own it and which have long-term responsibility, under regulation, for its use. For these reasons, we will not ordinarily grant contact rights for the use of poles or lease duct space to others for any purpose."

5. Telephone companies employed various tactics to give their channel lessees advantages over independent cable operators seeking attachments to telephone company poles.

Leasebacks were preferred by telephone companies to pole attachments because the telephone company owned the facilities, could control their use and could add their cost to the rate base to justify telephone rate increases. These advantages are not available when cable operators own potentially competitive facilities attached to telephone company poles.

AT&T, which was barred from the cable television business by the 1956 Consent Decree, typically priced its channel distribution leasebacks at less than cost to induce cable operators to lease facilities under AT&T control rather than construct their own facilities attached to AT&T poles.

AT&T, while precluded from the cable television business by the Consent Decree, wanted to at least maintain ownership and control over the distribution facilities. AT&T attempted to achieve this position by arbitrarily raising pole attachment rates, by imposing use restrictions on independently owned facilities and by employing its ability to cross-subsidize through marketing "... their own 'channel services' at remarkably low prices to encourage existing and potential cable communications companies to lease channels from Bell rather than construct their own".¹ AT&T admitted that its leaseback rates did not even cover costs.²

Further, the independent telephone companies actively involved in cable television through separate subsidiaries, such as United and General, filed tariffs which were only attractive to their subsidiaries, thus precluding competition. For example, "barrier to entry" rates could be set unreasonably high so that only the telephone subsidiary could afford service. Understandably, independent cable operators were unwilling to accept these restrictions.

6. Telephone companies engaged in protracted delays in arranging for pole attachments in order to force the independent cable company into accepting leaseback arrangements.

The Bell System's companies filed tariffs in the late 1960's offering to provide leased channel distribution service. While not refusing pole attachments outright, as

¹ Plaintiff's Answer to Interrogatory 51, *United States v. AT&T, et al.*, Case No. 74-6098 (D.C. Cir.) p. 283.

² *Id.* at 294.

did General and United, the Bell System companies adopted various policies, including unsupported increases in pole rates and delays in make-ready, "changeouts" and engineering inspections, which made it exceedingly difficult for an independent cable operator to compete in the marketplace with an operator who had leased channels from a Bell Telephone Company. After reviewing these policies and practices in *Better T.V. of Dutchess County, NY v. New York Telephone Co.*, 31 FCC 2d 939 (1969), the FCC concluded:

"The course of conduct followed by NY Telco employees in the communities under consideration such as the express or implied threats of delay if the cable operators persisted in their for pole attachment agreements, the interminable delays between each step of the processing from request to the attachment of the cable to the poles, the priority given to construction for the channel service customer and the other conduct detailed herein, establish to our satisfaction that the objective of such conduct was improperly to discourage attachment applications and to encourage the acceptance of common channel distribution service." 31 FCC 2d at 966.

7. Telephone companies built duplicative facilities to those provided by the existing franchised independent cable entrepreneurs for the benefit of the telephone company's cable subsidiary or for favored cable operators which leased channel distribution facilities from the telephone company.

For example, in Warrensburg, Missouri, in spite of the intense pressures brought to bear by United Telephone against local officials, a franchise was granted to an independent cable operator. The independent operator met with persistent opposition and delays from United with regard to pole attachments and essential procedures for the construction of a cable system.

Subsequently, United succeeded in obtaining a second "non-exclusive" franchise from the city for its subsidiary. United marshalled crews and equipment from its telephone subsidiary and was to complete construction long before the independent operator who has started first. This advance is crucial in an overbuild situation because customers typically start with the first company that offers them service. See, *Warrensburg Cable, Inc.*, 48 FCC 2d 910 (1973).

8. Telephone companies, with the only available poles, have required pole attachment agreements to be terminable at will.

Abuses by the telephone companies as to their pole attachments have been thoroughly detailed in the last two sessions of Congress during the hearings concerning the recently enacted pole attachment legislation.

For example, in 1976, North Carolina cable operators failed to pay a unilateral pole rate increase when Carolina Telephone & Telegraph, a United company, refused to offer any cost justification and would not even negotiate. The telephone company disconnected the cable from the poles, disrupting service in three communities.

Telephone companies have rarely had to exercise this terminability because its mere existence gives the telephone monopoly total leverage, especially with regard to pole rate increases. Furthermore, many lenders have avoided the cable industry in the past because they were unwilling to see such a tremendous investment in plant and electronic equipment be capable of destruction at the whim of the telephone company.

9. Pole attachment and leaseback agreements typically restricted the independent cable operator to one-way transmission of off-the-air television signals, thus preserving all other telecommunications markets for the telephone company or its cable subsidiary.

As mentioned before, telephone companies want to retain control over broadband facilities to preclude independent cable operators from offering services which do or might in the future compete with the telephone company.

In a Report on CATV Activity to its directors, United Utilities candidly admitted its intention to thwart competition:

"The United System went into the CATV business primarily to protect the interests of its operating telephone companies, in anticipation of future developments in communications which would require a broadband transmission facility. We wished to avoid having a potential business competitor build such a facility on United pole lines in towns served by United Telephone Companies." See, *Warrensburg Cable, Inc.*, 48 FCC 2d 910, 919 (1973).

The following examples of attempts to invoke these restrictions upon use of a cable operator's facilities are indicative of the potential for restraining competition.

On September 26, 1967, Michigan Bell notified Iron River CATV that its pole attachment agreement would be terminated if Iron River continued transmission of

a radio signal when the pole attachment agreement only allowed one-way transmission of television signals.³

New York Telephone denied the request of Ceracche TV Cable Company to transmit educational programs via cable to Ithaca College since this would be a two-way service. On May 27, 1968, Pacific Telephone denied a request for pole attachment privileges to a California cable operator desiring to install security surveillance cameras at customers' locations. Pacific Telephone *admitted* that the attachments were being denied because it offered similar services.

10. Telephone companies have the ability to use monopoly profits and telephone revenues to cross-subsidize cable operators.

State and Federal regulatory bodies have granted telephone companies a monopoly on local exchange switched voice service and allowed rates adequate to provide a "fair rate of return". This is done, at least in part, to assure universal telephone service and to provide accumulated capital for innovation, research and development, and modernization of the expensive telephone plant. Telephone companies, however, have used these accumulated monopoly profits to enter new fields and expand their monopolies.

In order to foreclose the independent cable operator from the market, cable television service could be initially offered at less than cost by the telephone company's cable subsidiary. These losses could be subsidized from accumulated monopoly profits or from other rate payers such as telephone subscribers.

Therefore, based on the history of passed "horribles" the FCC promulgated Sections 63.54, 63.57 and 64.601 of the Rules to prohibit local telephone companies from owning and/or operating cable systems within their specific telephone service areas.

³ Plaintiff's Answer to Interrogatory 51, *United States v. AT&T, et al.*, Case No. 74-6098 (D.C. Cir.), p. 284.

I. Exclusion of Potential Competition from Community Antenna Television (CATV)

1. Background

Television grew dramatically after World War II. Television signals are ordinarily broadcast omni-directionally from a central transmitter and picked up off the airwaves by individual television antennas. The farther a television antenna is from a transmitter, and the more intervening obstructions, the poorer the reception. The FCC initially granted television broadcast licenses only in the largest cities. As a result, television reception in rural communities far from the larger cities was poor or non-existent.

Community antenna television ("CATV") provides television programs to subscribers via coaxial cable rather than over-the-air broadcasting, eliminating the problem of poor reception. Antennas are built on mountain tops or other points of good reception to capture weak television signals off the air. The TV signals are then transmitted from the antenna site, which may be a number of miles from the population to be served, to the general vicinity of the subscribers where a system of cables distributes the signal to the homes of individual subscribers.

The first experimental cable system began in Astoria, Oregon, in 1948 and the first commercial system began in Lansford, Pennsylvania, in 1949 when an antenna was set up and cable was strung from tree to tree to bring the signals of three Philadelphia stations to a Western Pennsylvania community with poor television reception.

The early cable systems only had the capacity to transmit three television channels, and they were thus generally fully used by the available television signals. By the early 1950's the availability of inexpensive microwave radio allowed importation of distant television signals, via chains of transmission towers, for subsequent

distribution by local cable systems. At this time, AT&T and the Bell operating companies were busy satisfying the burgeoning demand for telephone service that followed the Korean War. There were approximately one million "held" orders, i.e., people waiting for telephone service, and the Bell operating companies were neither willing nor able to expend resources to construct microwave or cable distribution systems for television. In addition, AT&T viewed CATV as a temporary service which would disappear when the FCC expanded the markets in which it would allow television broadcasting.

CATV continued to grow in rural areas where television reception was poor, and by 1958 there were 525 CATV systems in operation. These early CATV systems soon found that trees were not an acceptable means for running their cable to their subscribers. Cost or local regulation made constructing poles on which to attach their cable or digging up streets to build underground conduit impossible. Accordingly, cable companies turned to the existing utility companies with their preexisting pole and conduit networks as a means of distributing their cable.

The Bell operating companies, as well as local power companies, held franchises which allowed them to construct both utility poles and underground conduit. CATV systems requested and needed access to the telephone poles owned by the Bell operating companies because the cost of building a separate pole system was prohibitive, and many municipalities simply forbade this alternative. The Bell operating companies had previously allowed pole attachments with Western Union, power companies and local government facilities. Unable to provide this service themselves, the Bell operating companies generally allowed CATV companies to attach cable to their poles for a "pole attachment" fee of from \$1 to \$2.00 per pole per year based on these past attachment agreements.

2. Growth of Cable and the Threat to AT&T and the Bell Operating Companies

In the late 1950's, three companies developed equipment which allowed up to 12 television channels to be transmitted and distributed over the coaxial cable systems then existing. This greatly

expanded the capacity of the existing cable systems. Now, in addition to television, cable companies could transmit other services to their subscribers.

In the early 1960's cable systems began to transmit and market other one-way services in addition to off-the-air television programming. In Encobeta, Ontario, a subsidiary of Paramount began offering Pay TV over one of its excess channels. In upstate New York two cable operators began offering closed circuit educational television ("ETV") over excess channels. Cable systems, including one in Uvalde, Texas, began offering I'M music. Cable operators, including one in Tyler, Texas, began offering locally originated television programming.

Furthermore, cable operators began to think about offering two-way services in competition with the Bell operating companies and many cable companies began plans to enter the larger urban markets with cable systems to provide better television reception to areas where tall buildings caused interference and to provide these new services.

Once installed, these new cable systems provided the possibility of high quality transmission of large capacity telecommunications. One television channel was the equivalent of hundreds of voice circuits. AT&T began to notice the increase in the number of cable systems across the country and initiated market studies to assess the impact of the new cable technology. These studies recognized the potential danger to AT&T's monopoly of full development of high capacity or "broadband" cable networks in local markets, the logical extension of CATV.

Technical developments in the last few years make it possible to incorporate a wide range of community services and interests into what was originally a means of providing better television reception. Local telephone distribution plant becomes a secondary offering when communities are wired with broadband communications capability. (A-1349A p.5)

Thus AT&T knew that a broadband network could replace the local distribution facilities of the Bell operating companies for certain telecommunication uses, including audio and video transmission, alarm signalling, meter reading and facsimile reproduc-

tion, and non-entertainment video services and two-way private line services. In addition, local cable systems owned by CATV operators, who would purchase their equipment from independent equipment manufacturers, threatened Western Electric's sales of equipment. To the extent that the cable systems would siphon off business from the Bell operating companies, they would need to purchase less equipment from Western to meet their needs. Finally, local cable systems represented a means by which intercity telecommunication carriers could distribute telecommunications to subscribers without being dependent upon the local distribution facilities of the Bell operating companies.

In 1964, AT&T established an office in its Planning Department to oversee CATV rates and policies, and AT&T became increasingly aware of the potential competitive threat of cable systems.

AT&T became increasingly disturbed by the potential of cable, which threatened \$550 million in revenues. Slide presentations to Bell management portrayed the threat of cable as a "monster". The potential market was obviously far greater than originally envisioned, "the threat to the Bell System's position in the communications field is real and imminent." [PIT 1276, C&P 0102], especially since the video and broadband services AT&T then offered were "incomplete, incompatible, inconsistent and conflicting." [AT&T 0110] AT&T realized that if it did not act quickly it would no longer be a full service communications carrier but would be relegated "to an outmoded, voice only equivalent of Western Union." [C&P 0200] Data transmission and even local exchange service might be lost.

In addition, other means of distributing television signals threatened AT&T's monopoly of telecommunications service. In 1966 the distribution of video signals was accomplished in New York by an experimental microwave system operated by Teleprompter Corp. AT&T informed all the operating companies about the CATV applications of such a system and the danger that it could lead to the obsolescence of underground cable. "Far more critical to future Bell System operations are other potential communications applications of such a system." [AT&T-13]

By 1967, a marketing study concluded that AT&T, in order to meet cable competition for broadband services, had to control the communications facilities needed to transmit them. AT&T stated tersely, "We must own that 'pipe' - not just own it more importantly - control it." [AT&T 0107.] If such control was not secured, AT&T said, "... we think we can lose the broadband market within five years." [ATT 107.] Accordingly, AT&T began to initiate practices designed to maintain AT&T and the Bell operating companies as the supplier of communications services in the United States.

3. AT&T's Response to the Threat of Cable

After AT&T recognized the growing threat of independent cable systems, it acted to insure that this threat did not become a reality. First, it began to insure that the Bell operating companies restricted the types of services that could be provided over the cable attached to their poles. Second, it directed the Bell operating companies to raise the pole attachment rates and used their relationship with power companies to obtain control over poles not owned by them. Third, it encouraged the Bell operating companies to initiate and lease to cable operators the equivalent of cable distribution facilities, called channel service, so that they could retain control over what services the cable operators transmitted over these channels. When this service attracted no business at its initial rates, the rates were systematically lowered to capture the market. Fourth, the Bell operating companies began a variety of tactics to restrict development of cable systems and delay and discourage competition from cable operators. Above all, AT&T tried to prevent one operating company from establishing an adverse precedent in its relations with cable operators for other operating companies. And finally, AT&T attempted to preempt the entire broadband market with its own abortive Picture Phone offering and proposals to "wire-a-city".

/a. Outright denials of pole attachments.

The Bell Operating Companies refused to allow pole attachments to cable companies under any conditions on numerous occasions. These denials were designed to prevent cable companies from constructing and operating their own cable systems

and thus force them to lease channel service from the BOCs if they wished to operate a cable system at all. The Operating Companies involved cited their introduction of channel service as the reason for refusing to allow pole attachments. New York Telephone, which at that time had excess transmission capacity and could provide the service itself, refused to grant pole attachments.

✓ b. Usage restrictions.

Once a cable system was in place, there were no technical barriers to transmitting all types of telecommunications in addition to television signals. In addition to providing television service for a flat monthly fee, cable operators could sell particular shows on a previewing or "Pay TV" basis. The facilities could be used for Educational Television ("ETV") for schools or closed circuit television ("CCTV") for business. There was nothing to prevent distribution of television shows originated locally, or FM music, time and weather information or stock market quotations. Finally, cable plant could be used to transmit data within local areas and had the potential for two-way transmissions of all types. AT&T and the BOCs however, already provided some of these services and viewed them as their exclusive province.

Prior to 1958, the license agreements between the Bell operating companies and the cable companies did not uniformly prohibit transmission of other than over the air television signals. However, since the technology limited capacity until improvements were made, there was little or no problem. After 1958, cable operators began to acquire the capacity to transmit additional services, and the Bell operating companies began to require and enforce these usage restrictions. The Bell operating companies thus began to prohibit cable operators from transmitting Pay TV, ETV, CCTV, FM music and two-way services, and prevented cable operators from re-selling their services. There was no technological basis for these restrictions and they were motivated solely by the desire of AT&T and the Bell operating companies to maintain control over all telecommunications.

A clause in a model pole attachment agreement used by Pacific Northwest Bell around 1966 represents the practice at that time throughout the Bell System:

Section 2. The licensee agrees that it will use its facilities attached to the licensor's poles primarily for the transmission of program material received off-the-air from, or furnished by standard television or FM broadcasting stations The licensee may make incidental use of the facilities to transmit to its patrons generally program material . . . distributed by closed circuit interexchange networks or such program material originated locally. The Licensor shall have the right to terminate this agreement on thirty days' notice to the Licensee if in the Licensor's judgment the Licensee's transmission of program material from standard broadcasting stations becomes or has become incidental to other uses or the licensee announces or has announced plans which will have that effect

Other BOCs had similar agreements.

AT&T discouraged all exceptions to the use restrictions to avoid setting precedents for cable operators in other places, for it knew the value of these usage restrictions:

Any enlarging of the privileges granted under the pole contract tends to make the service more valuable. This, in turn, will tend to encourage still more people to get into the business and the companies have enough to do to cope with the existing situation. [ATT-007]

Restrictions on the use that could be made of cable systems limited their profitability, delayed their growth and discouraged additional entry.

c. Increases in the Pole Attachment Rates.

As AT&T's perception of the threat of cable grew, AT&T encouraged the Bell operating companies to raise their rates for pole attachments, raising the cost to the cable operator of constructing his own system. At the same time, the Bell companies began to lease a service to cable companies, called channel service, which would allow the cable operator to deliver TV signals but would leave ownership and control over the distribution facilities with the local Bell operating company. In 1959, New York Telephone became the first Bell operating company to file a

tariff for channel service and it raised its pole attachment rates from \$3 to \$5.

At the direction of AT&T, other Bell operating companies began to raise rates and introduce channel service in the mid-1960's. Mountain Bell's pole attachment rates were increased from \$1.50 in 1959, to \$2.50 in 1964, and \$4.00 in 1968. Southwestern Bell rates were increased from \$1.50 in 1961, to \$2.50 in 1963, and \$3.50 in 1965. Michigan Bell rates were \$1.50 in 1963 and \$4.00 in 1968. South Central Bell rates were \$3.00 in 1963 and \$3.70 in 1969. Bell of Pennsylvania rates were \$2.50 in 1964 and \$4.00 in 1968. C&P of West Virginia rates were \$2.50-\$3.00 in 1964 and \$4.00 in 1966.

Additional rate increases were contemplated by Pacific Telephone and Telegraph, Pacific Northwest Bell, Southwestern Bell, and Mountain States Telephone and Telegraph but were not implemented because of actual or threatened regulatory action. The pole attachment rates were increased to deter cable operators from owning their own cable systems and to encourage them to lease channel service from the Bell operating companies instead.

To justify the higher rates, AT&T recommended that rates should be developed on the basis of fully allocated costs. The Bell operating companies followed this recommendation and by 1965 pole attachment rates averaged between \$3 and \$4, double what they had been in the 1950s. AT&T considered the costs for pole attachments and concluded that costs for pole attachments averaged about \$1.00. All the money earned over the \$1.00 cost was profit. However, AT&T refused to price pole attachments on the basis of actual attachment costs. Instead, prices were raised to just below the cost at which AT&T believed the cable operator could establish his own pole network, between \$4.00 and \$5.00 per pole:

Apparently, the incremental cost to the Bell System is expected to average about \$1 per pole attachment. The cost to a CATV company to provide its own plant and equipment, which will be of a lower quality would average between \$4 and \$5 per pole attachment, with high probability of added maintenance costs.

According to economic theory, Bell should charge a fee very close to the \$4 level. If these CATV companies can save

even 10 cents per attachment by buying them from Bell it would add that amount to their profits.

Charging a few cents below the \$4 level, however, is cutting it rather close, so it is probably better strategy to charge a fee somewhere in the middle ground between \$1 and \$4. [AT&T 033]

In 1968 and 1969, AT&T continued to attempt to find costing methods that would justify the pole attachment rates. However, no justification was ever found. Almost any rate charged would have benefitted AT&T and the Bell operating companies because additional revenue generated through pole attachment rentals flowed through to earnings.

AT&T's pole attachment rates so lacked objective justification that it advised the operating companies not to divulge costing information to cable companies as to how pole attachment rates were derived.

AT&T overpricing of pole attachment rates continued into the 1970s. The pole attachment rates were kept high to tie up cable company funds in pole attachments, thus preventing them from expanding their offerings into non-broadcast services which could compete with Bell services. These increased rates prompted complaints to the FCC and an investigation followed. However, the Commission refused to assert jurisdiction over pole attachment rates and ordered the National Cable Television Association and AT&T to negotiate their differences.

d. Use of the Relationship Between the BOCs and Power Companies..

When CATV companies began to operate, most utility poles were owned by both local power and telephone operating companies. These poles were of three types: (1) poles owned and used solely by a telephone company or another (usually electric) utility; (2) poles owned by one utility but jointly used by a telephone and electric company; and (3) poles jointly owned by both telephone and electric utilities. Since municipalities were understandably opposed to having two sets of poles along their streets, and the power companies and Bell operating companies allowed each other use of poles owned by each, relationships

between the Bell operating companies and local power companies concerning poles were governed by Joint Use Agreements.

In the late 1950's and early 1960's, most CATV companies had separate pole attachment agreements with power companies and telephone companies, and there were some tri-partite agreements among power, telephone and CATV companies. The early joint use agreements between the Bell operating companies and the power companies gave the pole owner the right to reject pole attachments by third parties; provided for the maintenance of previous privileges allowed to third parties by either party, by contract or otherwise; gave the grantor of third party attachments the responsibility for dealings with, or actions of, the third party; and required the permission of both parties before any rights or interests in the agreement could be assigned to third parties.

The power companies, for the most part, had differing attitudes towards CATV companies and therefore had satisfactory relations with them. Power companies considered CATV a public interest service and encouraged its growth. They generally recognized no technical or safety problems in CATV pole attachments, realized they benefitted from replacement of television antennas with cable because it eliminated some interference and maintenance problems for them, and considered CATV pole attachments an added source of income that would not otherwise have been available. Thus power companies had no objections, generally, to more than one attachment on their poles and had placed no restrictions on the types of services the cable companies provided over their cables.

The rates power companies initially charged for CATV pole attachments were similar to although generally lower than the rates charged by the Bell operating companies. As AT&T and the Bell operating companies began to perceive the threat of cable, they viewed the independent control of power companies over poles as a threat to their ability to control the uses made by cable companies of their cable. To forestall development of cable systems on the poles of power companies, the BOCs tried to insure that cable attachments would be made in the space on the jointly used poles controlled by them.

Early joint use agreements reserved separate measured amounts of pole length on jointly used poles for telephone company and power company use. The Bell operating companies began to define the part of the pole reserved for their use as "communications space" and the part of the pole reserved for power companies as "power space". Since CATV service and facilities were obviously "communications" in character, the Bell operating companies tried to convince the power companies that CATV attachments should be made in the "communications space", that space for which they were responsible.

Based on their control of the "communications space", the Bell operating companies then tried to convince power companies to allow them to act as the sole negotiators for pole attachments to joint use poles. Since most power companies were only interested in the revenues, they allowed the BOCs to act as sole negotiators for jointly used poles and referred CATV applicants for pole attachments to the Bell operating companies. The Bell operating companies received rentals for CATV attachments to poles they controlled under the joint use agreements, and usually provided the power companies a portion of the rental. However, the power companies ceased being involved in determining what rates to charge CATV companies for pole attachments. In some cases, the Bell operating companies refused to share CATV pole attachment rentals with power companies which caused disputes over the dispersal of rental fees and in turn caused delays in CATV pole attachments.

The existence of joint use poles allowed the Bell operating companies to delay pole attachments even though they claimed control over the "communications space". They delayed approving CATV pole attachments until they had initiated new joint use agreements with power companies. They requested that power companies delay approving CATV pole attachments until they had initiated new agreements with the CATV companies. And they asked power companies to delay CATV pole attachments until they had resolved their policy on CATV usage restrictions.

To expand the number of poles they could control, some Bell operating companies decided to purchase a half interest in poles owned by power companies or make poles "joint use" where they

anticipated requests for attachment by CATV companies. Other Bell operating companies asked power companies to deny attachments to CATV companies on poles used exclusively by power companies because these might become joint use poles in the future, and some power companies refused CATV attachments on this basis. The Bell operating companies even requested power companies to remove CATV company cable from joint use poles.

When the Bell operating companies began to raise their pole rates to discourage independent construction of cable systems by cable operators and encourage them to purchase channel service, they wanted to have the power companies raise their rates also. The BOCs were concerned about the discrepancy between the rates they charged for pole attachments, and those charged by the power companies for attachment to power company owned poles. Power companies and Bell operating companies met to discuss rates to be charged for CATV pole attachment, and the Bell operating companies discussed with power companies the possibility of raising and directly encouraged power companies to raise, the rates they charged for pole attachments. In the few cases where the BOC's rates for pole attachments were below those charged by power companies, the BOCs raised their rates to equal power company rates.

e. Introduction of Channel Service.

In 1959, New York Telephone filed the first channel service tariff. Southern New England Telephone and Southwestern Bell began to offer channel service in 1963 and by 1964 18 Bell operating companies had filed tariffs for channel service. These original tariffs were designed by the individual operating companies with no direction from AT&T, but proved to be commercial failures. The rates were too high and these channel service tariffs also contained usage restrictions which limited the kind of communications that could be transmitted. Cable operators preferred the cost savings and control that came with construction and ownership of their own systems.

In 1965 AT&T launched a program to secure control of cable distribution facilities. To do this AT&T lowered channel service rates to make them more attractive to cable operators. Southern

Bell slashed its rates in 1965 ever downward because it had no desire to furnish numerous pole attachments. Cost considerations were a secondary matter.

By 1966, Bell operating companies were offering channel service in 44 states. That year AT&T announced that, due to technological innovations, Southern Bell had developed channel rates far below those previously in effect, and that as a result, new lower rates were being filed by the other operating companies based on Southern Bell's new rates. Whether these lower rates were justified by lower costs is another matter. A presentation at AT&T's General Rate Conference in 1966 explained:

The Fall of 1964 saw the "price breakthrough" on channel service rates. Judging from what we now hear, this "breakthrough" was perhaps a little more enthusiastic than it had good reason to be. Possibly our desire to be "competitive" caused a little too much stretching of the savings that we felt were to be realized as a result of the technical advancements that the state-of-the art had experienced. (ATT 73 p.4)

Due to the price cutting of channel service rates and the increase in pole attachment rates and other restrictions on pole attachments, channel service proved to be moderately successful. In areas where service was available the Bell operating companies' share of the cable construction rose from nothing in 1964, to 28.4 percent in 1967. AT&T did not conduct studies to assess whether the channel rates covered costs until 1966, when the FCC assumed jurisdiction over the tariffs. Thus, these channel rates underwent a crash cost cutting in 1965, and early 1966, without any system-wide cost justification. And these low rates stayed in effect until October, 1969, when AT&T decided to no longer offer channel service.

AT&T cost studies demonstrated that channel service rates were below costs and had been designed purely as a competitive response.

In late 1966, AT&T studied the costs involved in furnishing channel service and its findings demonstrated that channel lease rates were non-compensatory. In 1967, AT&T concluded that the operating companies would have to raise their channel rates an average of 50 percent before they would be compensatory. An

AT&T spokesman at a Rate Conference in March, 1968, bluntly admitted that the channel rates were anything but compensatory and that Bell would be unable to support its rate levels before the FCC.

Channel service cost investigations continued into 1969. A 1968 cost study again concluded that AT&T's channel rates were not compensatory. AT&T's rate levels had been based on obsolete equipment, inexperience, lack of know-how and inaccurate cost assumptions. As a result, AT&T estimated that the deficiency level of revenues for channel service had reached an average level of 76.6 percent throughout the Bell System. In 1969, AT&T informed the operating companies that joint meetings would be held to decide on price revisions for channel service, and the operating companies were informed that the existing rate levels had been based on the cheapest equipment available, little experience and an "overriding desire to be competitive."

After considering abandoning channel service AT&T decided on blanket rate revisions for channel service in mid-1969. However, a few months later, in October, 1969, faced with the knowledge that channel service was being subsidized by monopoly services and under pressure from the FCC and cable concerns to allow for more development of an independent cable industry, AT&T decided to withdraw from offering channel service and to sell its facilities to the cable operators. Thus, despite repeated assertions of knowledge that channel service was non-compensatory and subsidized by the users of monopoly services, AT&T did not alter channel service rates between 1966 and 1969.

To construct cable systems cable operators often had to obtain franchises from local municipalities to use the public streets and rights-of-way. The franchising process can be time-consuming, triggering the attention of other potential applicants. Many Bell operating companies used the failure of CATV companies to obtain such franchises as a reason to delay or refuse granting pole attachment agreements. The Bell operating companies had already been granted franchises to use the streets in the communities in which they operated. To make their channel service more attractive to cable operators, the Bell operating companies offered cable operators access to the service area without the

necessity of obtaining a franchise by not requiring that the cable operator be franchised to lease channel service. Thus those cable operators willing to lease channel service from the Bell operating companies could enter the cable business with less delay than those cable operators who had to obtain a franchise, and could implement their systems months or years in advance of those operators who had to obtain their own franchising to operate.

AT&T knew that franchise avoidance was one feature which made channel service more attractive than construction and operation of an independent system, and an AT&T market study concluded that the franchise avoidance feature accounted for 12.8 percent of Bell operating company channel service sales.

✓f. Restrictions on Access to Telephone Poles.

In 1951, when CATV systems began to request access to telephone poles, AT&T viewed cable as a temporary phenomenon and placed no restrictions on the policies of the Bell operating companies in this regard and did not direct the practices of the Bell operating companies in this area. As a result, various operating companies followed different policies. Some operating companies refused to allow attachments at all, others permitted multiple pole attachments as long as there was room on the poles, and others allowed pole attachment until they began offering to lease channel service to cable operators under tariff, at which time they ceased allowing pole attachments.

In 1962, AT&T directed the Bell operating companies to refuse to allow more than one cable company to attach cable to its poles in any one geographic area, regardless of availability of space on poles. AT&T intended this policy to encourage the sale of Bell operating company channel service, and discourage the construction of non-Bell cable systems. At the same time, the Bell operating companies did not restrict the number of cable operators who could lease channel service, even though the BOC would have to put cable on poles for them.

Despite the announced policy, two or more cable operators often applied for pole attachments. AT&T instructed the Bell operating companies to refuse to choose between or among multiple pole attachment requests. As a result many Bell operat-

ing companies received a request for pole attachments, waited for a second application, and refused to choose among the applicants. The effect of the Bell operating companies' refusal to choose among competing applicants was to prevent any cable operator from constructing a cable system, and multiple applicants were offered the opportunity to lease channel service from the Bell operating company.

Pressure from cable operators and local communities desirous of obtaining cable television made the Bell operating companies' policy of refusing to choose among multiple applicants untenable.

On November 6, 1964 AT&T instructed the Bell operating companies to modify the policy to grant pole attachments on a first come, first (and only) served basis; however, they still refused to choose among "simultaneous" applications. However, no hard and fast guidelines were provided and finally AT&T directed the Bell operating companies to treat applications received within three calendar days as "simultaneous".

The refusal to allow more than one cable company in an area created other problems. Since CATV operators rarely needed all the poles in an area, some poles remained unused. Other CATV operators desired to attach cables to these poles. The Bell operating companies denied a number of attachments on this basis but there was no technical basis for the refusal.

To resolve this AT&T eventually announced to the Bell operating companies that they could allow the Bell operating companies to provide pole attachments to more than one cable operator in a given area, but that only one independently owned cable system could be attached per telephone pole. Any other cable company in the same area would have to lease channel service. If more than one cable company requested pole attachments simultaneously, the Bell operating company was to decline to decide which of the simultaneous applicants would be permitted to attach its cable. Instead, all would be offered only channel service under which the Bell operating company would construct the facilities and attach the cable to the poles.

However, since there was no restriction on the number of cable companies who could lease Bell channel service, there could be

multiple cables attached to single telephone poles by the BOCs. The policy merely limited attachment of independently owned cable company facilities to one per pole. This fact did not prevent AT&T from rationalizing its policy on the basis of safety, service and future needs. The policy was intended to protect AT&T's existing and future video service offerings and by 1966 all the Bell operating companies had, as a consequence of AT&T direction, imposed the new pole policy.

There was no technical justification for this policy. Multiple independent attachments had been permitted from 1951 to 1964 with little or no harm. Furthermore, in 1965, Northwestern Bell permitted the attachment of two independently owned cable systems on its poles in Hibbing, Minnesota, for fear that refusing either company's request would result in a lawsuit of some magnitude. As to the argument that there was insufficient pole space for multiple attachments, this is contradicted by the fact that the attachment policy in no way restricted the number of pole attachments, only the number of independently owned attachments, and there was no latitude given to permit multiple attachments where there was sufficient space.

AT&T knew that this policy would create customers for the Bell operating companies' leased channel service and admitted that many existing customers used leased channel service because they were unable to secure attachments for their individually owned cable. Furthermore, this policy discouraged cable operators from going into business and AT&T knew it. This policy also forced some cable companies who wanted to control their own facilities to refuse channel service and construct their own systems underground, greatly increasing their costs.

Furthermore, under the guise that applications were simultaneous the Bell operating companies denied attachments to all applicants, thus restricting cable and enhancing the market for its channel service. The refusal to choose among multiple applicants prevented development of any independent cable operators in some areas.

The "one-per-pole" policy was reviewed by AT&T a number of times between 1965 and 1969. Until 1969, any suggestion to

modify the policy was rejected. However, by 1969, the FCC was taking a dim view of these activities and the Antitrust Division had opened an investigation. Sensing possible antitrust pressure and fully cognizant of the speciousness of all the technical rationales it put forth, AT&T rescinded its "one-per-pole" policy. However, between 1964 and 1969 dozens of cable operators had their applications for pole attachment agreements denied by Bell operating companies because of this policy, regardless of the availability of pole space. The number of potential cable operators who failed to ever apply for attachment because of this policy is impossible to estimate.

The problems of TV Signal Co. of Aberdeen, South Dakota, exemplify the anticompetitive effect of this policy. TV Signal was granted a cable franchise in Aberdeen in March, 1969. It contacted Northwestern Bell and requested pole attachments for its proposed system. Although Northwestern Bell owned less than 20 percent of the poles in the city, through its joint use contract with Northwestern Public Service Company, Northwestern Bell had authority over all pole attachments in Aberdeen. Northwestern Bell refused TV Signal's request, based on AT&T's "one-per-pole" policy, because it had granted pole attachments to Aberdeen Cable TV Service, Inc., which had been granted a franchise in August, 1968. At this time Aberdeen Cable had yet to begin building its system, because its franchise had been rejected by popular vote. Until the litigation could be settled, Aberdeen Cable could not construct its system. Northwestern Bell offered TV Signal channel service but TV Signal desired to retain facility ownership and declined the offer.

In July, TV Signal again requested pole attachments from Northwestern Bell and was refused. To retain control of its cable facilities TV Signal was forced to construct an underground system, which cost \$1,800 more per mile than an aboveground system.

By the time AT&T rescinded its "one-per-pole" policy on October 28, 1969, TV Signal had constructed most of its system underground. After AT&T's announcement, Northwestern Bell offered TV Signal pole attachments and the remainder of TV Signal's system was constructed above ground. Still, the cumula-

tive effect of AT&T's "one-per-pole" policy was to render TV Signal's system more expensive to construct than it would have been had this policy not been in force.

g. Denial of Access to Underground Facilities.

In addition to instructing the Bell operating companies not to provide access to more than one attachment in an area, AT&T instructed the Bell operating companies to refuse to allow cable operators to pull cable through duct space in underground conduit controlled by them. AT&T initiated this policy of refusing to allow its underground duct space to be made available to cable companies in 1964, and continued it until 1969. This precluded cable companies from constructing systems in large cities where telephone poles were either impractical or were not allowed and where underground construction was the only means for creating a cable system. This protected the largest markets for Bell operating companies' channel services and insured that no other entity would have the capacity to distribute video or other telecommunications signals.

In at least seven instances, AT&T and the operating companies denied cable systems access to underground duct space and offered channel service instead. Most cable companies did not want to lease channel service and preferred the cost savings and control that went with the construction and ownership of their own cable system. Thus, the duct access policies placed cable companies at a competitive disadvantage in any future development of cable service and technology.

There was no technical basis for these refusals. One operator refused such access complained to the New York PSC. In the course of a proceeding before the New York Public Service Commission concerning access to New York Telephone underground ducts, New York Telephone tried to establish a number of reasons for denying access, including that cable presence in the ducts would be disruptive, would threaten vital communications, would cause blackouts and would impair national security. However, AT&T allowed duct access to cable systems where the Bell operating companies constructed channel facilities for lease and in no instance where a cable system existed in ducts had any such

problems occurred. The New York Public Service Commission rejected these arguments and ordered New York Telephone to allow duct access to cable companies.

The Bell operating companies also used their relationship with power companies to prevent power companies from allowing cable companies access in the underground ducts owned by the power companies. For example, Southern New England telephone simply met with the power companies in their area and agreed that neither would provide access to their underground ducts.

h. Refusal to Provide Partial Channel Service.

Some cable operators desired to lease part of their cable systems from the local Bell operating company and to construct part themselves. AT&T refused to allow the Bell operating companies to provide such facilities under these circumstances at any price, regardless of the availability of such channels. The channel service tariffs filed at the direction of AT&T contained the provision that customers had to take an entire distribution system rather than only portions of one. This policy was designed to restrict the operation of independently owned systems and to enhance the market for the Bell operating companies channel service. Forcing the cable owner to either lease an entire AT&T system or build his own system restricted the cable owner's flexibility in choosing the mix of facilities which would be most cost efficient.

In 1964, Long Island Cablevision Company sought to extend its area of service by leasing a channel from New York Telephone and interconnecting it to its owned and operated system. New York Telephone refused the request.

AT&T surveyed the operating companies and most backed its position. As a result all the Bell operating companies including four operating companies that favored liberalized leasing, were told to and did follow AT&T's policy. In one instance, Pacific Telephone decided to allow interconnection between CATV owned and Bell leased facilities, but AT&T persuaded it not to do so.

In June, 1968, the FCC halted further construction of all telephone company owned and operated CATV distribution facilities until applications for certificates of convenience and necessity had been approved by the Commission. As a result of the delays in construction that arose out of this decision, AT&T decided to review its interconnection policy. AT&T knew that by refusing to lease existing facilities it could be subject to liabilities and might very well have interconnection imposed on it by the FCC. Thus AT&T's knowledge that it could not justify any interconnection restrictions on technical grounds, and regulatory pressure led to the abandonment of this interconnection restriction in 1969 to accommodate the delays occasioned by the above FCC decision.

i. Miscellaneous Harassment of Cable Operators by the Bell Operating Companies

The local Bell operating companies had the ability and the incentive to harass, delay and obstruct independent cable operators from accessing their telephone poles and underground conduits and to favor cable operators who provided service over their channel facilities. The opportunity for such anticompetitive conduct arises in many places and includes everything from the refusal to provide maps of telephone pole layouts to excessive charges for telephone pole surveys, and make ready work, to high insurance and bond requirements and exorbitant rearrangement costs.

The FCC found that at least one Bell operating company, New York Telephone, had engaged in such conduct to obstruct three cable operators. New York Telephone shunted the cable operator back and forth between itself and the local power company for pole maps and failed to produce pole records which it had for the purpose of delaying the commencement of the CATV system. The FCC concluded that the telephone company accomplished its purpose by "its tortoise-like responses to inquiries and its generally uncooperative attitude." The Commission analyzed other examples in other communities and reached similar conclusions.

The course of conduct followed by N.Y. Telco employees in the communities under consideration such as the express or implied threats of delay if the cable operators persisted in

their requests for pole attachment agreements, the interminable delays between each step of the processing from request to the attachment of the cable to the poles, the priority given to construction for the channel service customer and the other conduct detailed herein, establish to our satisfaction that the objective of such activities was improperly to discourage attachment applications and to encourage the acceptance of common carrier channel distribution service. This objective of the telephone company was to be accomplished by persuasion as to the advantages of channel service over an operator owned system, if possible, but if not possible by such persuasion, than by utilization of such pressures upon the applicant as would be likely to bring about the desired result. Since the telephone company owns or controls the utility poles so essential to the construction of a cable system, it was in a position to use a variety of pressures in pursuit of its goal of forcing the acceptance of channel service or eliminating the requesting CATV operator as a competitor to the channel service customer in the community, and it used them. In Hyde Park, Better T.V. was kept off the poles until a channel service customer was obtained and the construction for the customer could be completed. Suffolk Cable, in addition to all of the other delaying tactics employed by N.Y. Telco, had its make-ready space used for its competitor's channel distribution facilities and never was able to get started in Eagle Estates. In Poughkeepsie, WEOK Cablevision quickly took the hint about the lack of manpower to perform make-ready work and accepted channel service rather than run the risk of having the competing channel service customer get such a head start as to make a grant of its request for a pole attachment agreement an empty and worthless gesture. We conclude, therefore, on the basis of our review of the evidence of record, that N.Y. Telco subjected CATV operators who desired to construct their own CATV systems to undue and unreasonable prejudice and disadvantage and extended undue and unreasonable preference and advantage to its channel service customers and potential channel service customers. The purpose of the conduct established herein was to either induce the independent CATV operators to take unwanted channel service or to impede and delay construction of their CATV systems until a channel service customer could be obtained and channel distribution facilities could be constructed.

Better TV Inc. of Dutchess County, 31 FCC 2d 939, 966-7.

4. An Illustration of the Activities of the Bell Operating Companies: CATV and Southern New England Tel. Co.

Southern New England Telephone Company ("SNET") was one of the few Bell companies that had no pole attachment agreements with CATV operators in the early period of cable. When asked for pole attachments, SNET claimed that they were not allowed to provide such attachments under Connecticut law, and refused to ask the PUC to allow them to provide such attachments. On June 24, 1963 the Governor of Connecticut signed into law Public Act No. 425, "An Act Concerning Community Antenna Television Systems." The bill allowed CATV applicants to obtain a certificate from the Public Utilities Commission. SNET now reviewed their past studies of rental charges for pole space, and prepared to file tariff charges for such rental, but not until action was indicated by the PUC.

On July 3, 1963 a SNET CATV "group" met to discuss the Act. They recognized that they were "now required to provide pole space for attachment rentals for CATV," but noted that the "language of the Act does not sharply define the scope" of CATV and warned that "... CATV activities may be expanded in the future to include subscription TV, ETV, etc. This leaves a question as to our attitude if we are later requested to provide pole attachments for these purposes." (SNET-81)

The SNET people subsequently contacted AT&T to see "how far they felt we could realistically go in our proposed tariff filing in limiting the scope of CATV activity, in order to prevent the use of pole attachments for purposes not generally recognized as within the scope of CATV." AT&T's C.C. Harmon indicated that limitations of scope should not differ from that specified in tariff offerings for channel services, i.e., "limited to transmission of program material received off-the-air from broadcasting stations." The limitations in the New York Tel tariff were "highly desirable" but SNET was warned not to go all out to express positive limitations "which might result in creating issues that would have to be resolved at this time (prematurely)." Harmon suggested SNET investigate "whether the Commission would accept the filing of individual contracts rather than a tariff"

because "much more of all the required conditions can be put in a contract."

The SNET CATV group met again on July 17, 1963 after two of its members, W. F. Robb and Robert S. Medvecky discussed CATV with New York Tel. They concluded: "It seems advisable to include in our tariff filing a definition of CATV that would positively exclude other uses." (SNET-40)

SNET now began to meet with the power companies. On August 29 W. F. Robb reported on meetings with United Illuminating, Connecticut Light and Power and Hartford Electric Light to discuss CATV use of poles solely owned by the power companies or owned jointly with SNET, and the sharing of costs and revenues. The group resolved the issue of providing duct space to CATV. "It was agreed that duct space should not be made available for CATV use; however it was felt necessary to have the reasons set forth for making the decision." (SNET-45)

SNET's Robb and Medvecky went to AT&T again on October 2, 1963 to discuss their proposed tariff and contract provisions on CATV pole rentals with Messrs. Joiner, Fletcher and Ross of AT&T. With minor changes, they found them acceptable, but certain items were held "subject to policy review." Foremost among these concerns was limiting the use of pole space "solely to provide community antenna television service." AT&T suggested that SNET try to get the PUC to limit CATV services.

If we try initially to exclude all these services [paid TV, FM, local news, ETV] and the subscriber later adds certain of them, even paid TV, it would probably be very difficult to resist the addition.

If the PUC, however, puts such limits in their certificate of convenience and necessity, the situation would be better. It was suggested that we might meet with the Commissioners to discuss their feelings regarding paid TV and occasional use other than the off-the-air pick-up of TV. It is understood that no where else in the Bell System do the pole rental contracts permit paid TV or leasing of channels to schools for ETV.

If necessary to permit occasional use of TV channels, certainly limit to ETV provided by the CATV operator free of charge. (SNET-41)

SNET needed to resolve the role of power companies in renting pole space to CATV, as there were numerous jointly owned poles, and poles solely owned by power companies in which CATV operators might also be interested. To control these poles, SNET considered . . . "whether we should buy 1/2 interest in electric poles solely to provide attachments for CATV." (SNET-81)

On September 4, 1963, SNET and representatives of the three power companies met at the offices of Connecticut Light & Power to discuss alternate proposals for dealing with CATV. Mr. Probst of Connecticut Light and Power:

. . . opened meeting by stating that the Connecticut electric companies had discussed the alternate proposals for dealing with community antenna television systems and had decided that the best method of dealing with the antenna companies would be to have SNET deal exclusively with said companies. (SNET 66)

SNET would purchase one-half interest in all non-joint poles and derive all revenues. "[T]he parties agreed that this method would be suggested to the Public Utilities Commission" at the September 6 meeting. The parties further agreed it ". . . desirable to have their technical design and rate people meet to draw up acceptable standards for the manner and location of placing antenna system facilities." (SNET-66)

SNET's position on the purchase of non-joint poles apparently changed in early 1964, and this proposal did not come about. A further meeting with power company representatives was held March 31, 1964 to discuss joint pole attachment arrangements. Medvecky explained SNET's fear about the . . . "capabilities for future expansion to other fields of CATV, particularly involving telephone." (SNET 70) He then argued why SNET should control the relationship with the cable operators for pole attachments. "Telephone needs control for the future. Power companies have no particular incentive or reasons to fight CATV on these matters." (SNET 70) He explained the administrative difficulties but indicated SNET's willingness to "deal with CATV."

Apparently the power companies found the "Original plan [purchase of 1/2 interest] quite satisfactory, but telephone ruined

it. If power has to get into the problems of CATV may as well go all the way." (SNET 70)

SNET's Medvecky proposed an agency solution, where SNET would take the "headaches." SNET's Hartt emphasized the importance to the telephone company of "... long term control of CATV indicating visions of Pay-TV, ETV, Weather and municipal circuits." He also pointed out involvement of political and public press figures on CATV boards and said they would consider a plan where they would take prime responsibility, as far as possible. Medvecky explained SNET's goal again. "Pay-TV appears to be in the picture. We want to own cable for the long term and lease circuits." (SNET 70) The power companies apparently agreed and the meeting ended with SNET to work out and submit a proposal.

Further meetings were held April 17 and 29, 1964. The parties agreed that SNET would be the power companies' authorized agent for poles owned solely by them. They also resolved the question of access to underground conduit. "There will be no offering of space in underground conduits, by Power and Telephone, for CATV."

During this period, AT&T and the other BOCs helped determine SNET's posture. A New England Telephone document provided to SNET detailed CATV's general history and explains their policy. Where CATV operator desires to establish a system "we will attempt to sell him our facilities" where tariffs approved.

On December 3, 1965, SNET representatives were again "sent down" to AT&T to see if their tariffs "... are consistent with B. S. position" (SNET 74), and to prepare for an upcoming state PUC hearing. I.H. Schlesinger, Jr., Medvecky and F.F. Fagal met with C.C. Harmon, Norm Pullan, Harold Levy and Leo Likoff of AT&T. Minutes of this meeting indicate that SNET's situation regarding incidental use, was somewhat different because of Connecticut law and a PUC order in Docket 10250. The system position was to allow these uses because in the rest of the system they were not legislated against and they had "... crept into usage elsewhere and cannot be forbidden now." (SNET 74) AT&T advised SNET "... not to initiate any action to offer to

allow incidental uses . . . unless we are forced to do so by the PUC." (SNET 74)

AT&T suggested how to handle the PUC. "[I]t might be worthwhile to try to convince the PUC before the hearing that . . . future developments . . . should be in the jurisdiction of the telephone company and that CATV operators should be confined to television transmission." (SNET 74) AT&T explained that the type of PUC hearing that would be to SNET's advantage "should be as informal as possible" and they might want to try to get the PUC to condition the granting of a CATV franchise upon taking SNET's channel services. The other point to be stressed was SNET's "... ability to provide channels better (and cheaper if we can prove it)." (SNET-74)

On June 17, 1964, SNET filed its first channel service tariff. The original charges seem to have been \$25 per month per 1/4 mile with a \$25 installation charge and a \$45 per month for each "drop."

Under these rates, SNET sold no CATV channel facilities. On June 25, 1965, the rates were lowered, and service was provided under two options: (1) \$16.50 per month per 1/4 mile, with a termination charge of \$500 per 1/4 mile, to be reduced monthly over ten years; or (2) \$11.25 per 1/4 mile with a non-recurring charge of \$500 per 1/4 mile in lieu of termination charge. The installation charge for each "drop" was reduced to \$20, or \$15 if coincident with installation of associated distribution facilities. The monthly rate per drop was reduced to \$40. Under these rates, no channel facilities were sold either.

SNET continued to try to lower rates. On January 27, 1966 a CATV cost study memo ascertained the effect of excluding indirect operating expenses commonly referred to as administration expenses from costs. If this were done, the monthly rate could be reduced from \$16.50 to about \$13.50.

SNET reviewed the revised rates with representatives of AT&T Rate and Engineering Departments. AT&T apparently did not agree completely, "with the extent of the reduction." "The general consensus of the AT&T study group was that the engineering appeared solid but that the annual charges in every case

appeared to be developed by the 'sharp pencil' technique." Something more than \$12.00 appeared more justifiable, and George Spalding suggested \$13.00 "might be safer."

SNET justified its lower rates by SNET's purchase of equipment directly from the supplier, while the AT&T study assumed purchase through Western Electric under KS specifications. Western's price was approximately 10% higher.

On April 7, 1966 lower rates were again filed with the Connecticut PUC. This time the mileage rate was reduced to \$12.00 per 1/4 mile and the termination charge was reduced to \$340. The monthly rate was reduced to \$35. The option of paying a lower monthly rate with an initial non-recurring charge was discontinued. For the first time SNET offered underground distribution in conduit at \$25 per 1/4 mile, with a termination charge of \$725. SNET told the Connecticut PUC that these reductions were made possible by "[t]he availability of improved equipment and installation techniques with their attendant affect upon installation and maintenance, and lower cable costs. . . ." (SNET-92)

By this time, the FCC had directed the Bell operating companies to file tariffs for CATV facilities with it rather than with state PUCs. Under protest, AT&T filed tariffs for the various Bell telcos on May 6, 1966. AT&T filed a petition for reconsideration, which was denied on June 29, 1966, and it became necessary to "reissue these tariffs as F.C.C. interstate tariffs conforming to the Commission's tariff rules," SNET determined that the FCC had pre-empted all Connecticut PUC jurisdiction (as opposed to other states where incidental CATV use was still intrastate) and withdraw its state tariff filing effective the date of the FCC filing.

In September of 1966 SNET began to develop cost support for the various parts of its channel services rates, but decided not to file this cost back-up with the FCC to avoid potential conflict with other Bell operating companies. "It was felt that any major change in the tariff at this time might invite an immediate request for cost back-up from the F.C.C. before the operating companies had an opportunity to compare their back-up." (SNET-79)

On October 21 the FCC ordered an investigation into the BOC CATV tariffs on its own motion, and FCC counsel requested

information from SNET on November 1, 1966. AT&T advised on Nov. 11 that "little or no effort should be given to answering" this request as the content was being negotiated informally by AT&T with the FCC staff.

5. Regulation of Cable Television.

In the early 1950's, there was no federal regulation of cable television, and little state or local regulation. In 1956 and 1959, the FCC considered regulation of cable television but rejected it on the grounds that cable operators were not common carriers and its authority over broadcasting did not extend to cable television. States did not regulate cable operators and not all municipalities required local franchises.

AT&T and the Bell Operating Companies attempted to persuade state and municipal authorities who franchised cable companies to restrict the activities in which a cable system might engage and also attempted to limit competition by persuading regulators of franchised cable companies to permit only one cable firm to serve any given area. When the Bell operating companies began to offer channel services to CATV operators, this service was provided under tariffs filed with the several states or, in the case of Texas, with municipalities.

In 1962, the FCC took the first step toward cable regulation when it began to condition grants of authority to build microwave systems to relay television programming for local distribution upon a showing by the applicant that the CATV operator using the signals transmitted over the microwave facilities was not duplicating local station programming. In 1965, the Commission expanded this ruling and assumed jurisdiction over cable operators that imported television signals over these microwave systems on the grounds that they were engaged in interstate commerce. In 1966, the FCC expanded this ruling further and asserted jurisdiction over all cable systems on the basis that cable systems were engaged in interstate communication by wire.

In addition, the FCC explored taking jurisdiction over the channel service tariffs. AT&T and the BOCs objected, claiming that their leased service offerings to cable operators were purely intrastate in nature. Nevertheless the Commission rejected this

and ordered them to file their tariffs for channel services provided to CATV operators with the FCC rather than with state commissions.

In 1968, the Commission determined that telephone companies had to apply for authority under 214 of the Communications Act prior to constructing distribution facilities to provide channel service to cable companies, and that the facilities to be constructed not duplicate existing facilities. This ruling ended the advantage that the Bell operating companies had over cable companies in the speed with which cable distribution facilities could be constructed. Before, cable companies could not construct facilities until franchised to do so while telephone companies could construct facilities without such a sanction. Now, both had to obtain regulatory permission to construct cable distribution systems.

In 1969, the FCC initiated an investigation into whether telephone companies should be barred from offering cable television service and in 1970 the Commission adopted rules prohibiting a telephone company from directly or indirectly furnishing cable television service to the viewing public in its telephone service area. Furthermore, the FCC ruled that CATV operators were free to choose between owning the cable and renting pole spaces from the telephone company or leasing channel service from the telephone company under tariffs.

Despite the contention by the Bell companies that the FCC lacked jurisdiction, the FCC expressly ordered the end of discrimination against independent cable companies by the telephone companies.

It appears from the record in this proceeding, as well as from the various other information heretofore formally brought to our attention, that the potential seedbed of the controversy has been the independent CATV systems' alleged difficulty in obtaining pole line attachment agreements from the local telephone companies. Since pole lines are an essential part of the problem, they must necessarily be also part of the solution. Consequently, it is our further conclusion that any further authority to a telephone company under section 214(a) of the act to provide CATV channel facilities, should be conditioned upon a documented

showing that the customer CATV system had available, at its option, pole attachment rights (or conduit space, as the case may be) (a) at reasonable charges, and (b) without undue restrictions on the uses that may be made of the channel by the customer. This option must be open to the CATV customer not only at the time of the grant but also prior to its decision to seek an award of a local franchise. Additional showing is also required that this policy was made known to the local franchising authority.

Pole line attachment (or conduit) rights must be offered on a nondiscriminatory basis where space for such facilities can reasonably be made available without impediment to the telephone company's obligation to supply non-CATV communications services to the public. The existence of technical limitations, which might prevent the leasing of space for additional lines on existing poles, should be convincingly shown by the telephone company and the exception be limited to the duration of the technical problem. (21 FCC 2d 307, 326-7.)

After this opinion, the BOCs stopped offering channel service, and thus were governed by the conditions with which they would have had to comply for pole attachment if they desired to provide channel service.

6. Defendants' Attempt to Capture the Entire Video Market and the Development of Picturephone.

As cable systems developed in urban areas, AT&T began to realize that cable systems threatened to replace the services of the BOCs for all video offerings. Accordingly, in the mid-1960's AT&T began to develop a service which attempted to use, as much as possible, existing wire pair facilities designed for voice transmission to distribute video or wideband communications. This service was called Picturephone and was designed to provide a limited resolution picture which could, in many situations, be distributed over wire pairs. At least as early as 1968, AT&T realized that there were other "numerous possibilities for distributing wideband communications service within local communities," discussions between AT&T's Marketing and Engineering Departments established their common ground.

Establishing the Bell System's responsibility for providing PICTUREPHONE service is recognized as a primary and crucially important objective. High management commit-

ment to this objective is expressed by the large Bell Laboratories, Western and AT&T efforts being expended. (ATT 114)

However, there was uncertainty over whether the CATV facilities then being constructed could provide Picturephone service in the future, and there was clearly concern:

... that non-Bell ownership of any broadband distribution facility will lead to political and regulatory pressures that will exclude the Bell System from all or some portion of the PICTUREPHONE market. There appears to be no way, short of Bell System ownership of all communications distribution facilities, of absolutely insuring against this possibility. (ATT 114)

To accomplish this "ownership of all communications distribution facilities," AT&T established the policy of providing channel service to CATV and other wideband customers. However, AT&T recognized that:

[W]idespread implementation of Bell System CATV channel service is impeded by competition, possible regulatory opposition and as yet unresolved tariff-cost relationships. In addition AT&T Engineering and Bell Laboratories development activities are not adequate to support a maximally effective Operating Company activity in this field.

Based on these impediments and the present and foreseeable technology it is certain that the expected rapid expansion of CATV service to the public during the next few years will be accomplished with facilities that are separate from the Bell System's telephone network and to a considerable extent owned by others. This observation suggests that the Bell System's CATV policy [sic] should be reviewed with the objective of devising a practical and effective course of action. [ATT-114]

Although AT&T had done little work to define and determine the cost of specific services and no sound information on the price/demand relationship that would ultimately determine the validity of Picturephone was available, large resources of Bell Labs and AT&T were devoted to development of Picturephone so that AT&T and the BOCs could preempt all demand in this area and own the facilities used to provide these services. After a number of years and hundreds of million dollars of development costs, Picturephone was abandoned.

7. Refusals to Let CATV Systems Use Their Facilities to Provide Private Line Service.

Local Bell operating companies refused to allow CATV companies to use their existing facilities to distribute telecommunications such as radio programming transmittal from national radio networks to local radio stations for broadcasting. In this way, the Bell operating companies prevented development of an alternative distribution system for intercity transmission carried by competitors of AT&T's Long Lines Department and restricted the growth of these competitors.

In February, 1967 two radio stations in Michigan's Upper Peninsula, WIKB of Iron River and WJPD of Ishpeming, contracted to receive NBC radio programming for broadcasting. Upper Peninsula Microwave, Inc. (UPM), a Miscellaneous Common Carrier, relayed NBC's radio programming via microwave towers between the Amberg Telephone & Telegraph Company and pickup points of Michigan Bell Telephone (Amberg picked up the signals from Wisconsin Bell). The signal was then transmitted to the local stations for broadcasting by Michigan Bell's "local loops." On May 25, 1967 Michigan Bell notified the radio stations that its carriage of this radio signal would be discontinued, as it had been provided "in error" because UPM was not a concurring, connecting or participating carrier, and therefore did not qualify for interconnection under existing tariffs. Michigan Bell informed the radio stations that if they wanted to receive NBC's radio signals for broadcasting, they could do so over Bell facilities at Rhineland, Wisconsin. On May 29, the radio stations filed a complaint with the FCC but Michigan Bell discontinued their service on midnight May 31.

The two radio stations unwilling to pay the rate charged by Wisconsin Bell, tried to keep using UPM by contacting two cable operators to provide the local loop from UPM's microwave tower to their studios to replace the facilities Michigan Bell refused to provide when UPM facilities were used for the intercity portion of the transmission. They contacted Iron Range Cable Branch and Iron River Community Antenna Television Company (Iron River CATV) for alternative facilities. WIKB of Iron River obtained

service from Iron River CATV but arrangements could not be made for WJPD.

Michigan Bell learned that the radio stations had "found a way around" its facilities and had to "cut this off a second time."

On June 9, 1967 Wisconsin Bell notified the manager of Amberg Telephone:

. . . that the connection of our facilities with those of your company which carries NBC radio network programming to be delivered in the Upper Peninsula of Michigan via Upper Peninsula Microwave, Inc., was made in error, since Upper Peninsula Microwave, Inc. is not a concurring, connecting or other participating carrier. Accordingly . . . we are taking the necessary steps to discontinue, on Monday, June 12, 1967, the connection in our office in Marinette, Wisconsin, the source of the program transmission to Upper Peninsula Microwave, Inc. (MBT-47)

On June 14, 1967 Michigan Bell's District Commercial Manager-Northern wrote to their Division Commercial Manager-Central, warning that the attempt to use CATV facilities, if not challenged as a breach of contract, would lead to other attempts and recommended that they "make perfectly clear . . . that we consider this a breach of contract (if indeed we do), and that if our present contract is inadequate, we consider revising it to meet our current needs."

On July 26, 1967 A. J. Thorburn, a Michigan Bell attorney, wrote indicating he considered use of CATV facilities to transmit signals for radio broadcasting in violation of the joint use agreements, and recommended that the two CATV companies be notified that Michigan Bell "will take all required legal action to terminate the agreement or otherwise prevent violation of the uses for which pole attachments are permitted."

On August 17 the radio station complained to the FCC, by telegram, that Michigan Bell was interfering with their negotiations for facilities. On August 23, 1967 Michigan Bell formally notified Iron River CATV by letter that their transmission of NBC radio programs for broadcast by WIKB violated their pole agreement. They were given 30 days to correct the situation or the joint use permits would be terminated.

AT&T was advised of these matters, and considered asking Michigan Bell to overlook the contract violation and permit service to be continued. The problem was that WJPD in Ishpeming would request the same service from Iron Range Cable, which had already been informed that this would be a contract violation. Furthermore, half a dozen other stations in the Upper Peninsula had requested similar service and been refused. There were other problems with permitting an exception.

Another and more serious matter from a public relations point of view is the problem of the sports network of NMU. [Northern Michigan University] How can we refuse a non-profit use (that they also regard as educational) when we don't prevent commercial use? (MBT 112.)

WIKB continued transmitting and on September 26, 1967 Michigan Bell informed them that all joint use permits concerning poles used in furnishing the service were terminated; if cable and other facilities were not removed by October 1, Michigan Bell would remove them.

On September 26, Iron River CATV asked Michigan Bell to bear with them until they set up their own poles. "You wouldn't be so brutal as to cut us off." To maintain service, Iron River CATV planned to place 150 new poles and remove contacts on 100 others and place them on power company poles. Michigan Bell discussed this and raised the question of their 38 year old agreement with the Upper Peninsula Power Company, which forbid contacts on poles covered by the agreement without written consent of the other party. Michigan Bell recognized the problem of forcing the CATV company into constructing duplicate pole lines and invoking the existing agreement with the power company to prevent the CATV company from obtaining these contacts. Nevertheless, Michigan Bell's staff desired to call the power company and advise them that they would not consent to granting third party attachment rights. Iron River CATV disconnected its facilities from Michigan Bell's poles and moved them rather than discontinue service to WIKB.

WJPD tried to negotiate similar arrangements with Iron Range Cable Branch, the Ishpeming CATV Company, a subsidiary of TeleSystems. On August 14, 1967 WJPD was advised that

TeleSystems had decided that "it is not in our best interest to carry the above programming at this time."

Method of Proof

FCC Proceedings:

Frontier Broadcasting Co. et al. v. J. E. Cellier and Carl O. Krummel, doing business as Laramie Community TV Co. et al.

Docket 12443 - In the Matter of Inquiry Into the Impact of Community Antenna Systems, TV Translators, TV "Satellite" Stations and TV "Repeaters" on the Orderly Development of Television Broadcasting.

Docket 12931, File No. 2463 - C1-P-58 - In re Application of Carter Mountain Transmission Corp. Cody, Wyo. for Construction Permit to Install an Additional Transmitter to Transmit on Frequency 6387.5 Mc. Location: Copper Mountain, 20 Miles South of Worland, Wyo.

Dockets 14895, 15223 - In the Matter of Amendment of Subpart L, part II to Adopt Rules and Regulations to Govern the Grant of Authorization in the Business Radio Service For Microwave Stations to Relay Television Signals to Community Antenna Systems. Amendment of Subpart I Part 21. To Adopt Rules and Regulations to Govern the Grant of Authorizations in the Domestic Public Point-to-Point Microwave Radio Service for Microwave Stations used to Relay Television Broadcast Signals to Community Antenna Television Systems.

Docket 15971 - Amendment to Parts 21, 74 and 91 to Adopt Rules and Regulations Relating to the Distribution of Television Broadcast Signals by Community Antenna Television Systems and Related Matters.

In the Matter of Commission Order, Dated April 6, 1966. Requiring Common Carriers to File Tariffs with Commission for Local Distribution Channels Furnished For Use in CATV Systems.

Docket 16298 - (consolidated Dockets 16943, 17098) FCC Tariff No. 1 and FCC Tariff No. 2 Applicable to Channel Service for Use by Community Antenna Television Systems.

Docket 17484 - Northland Advertising Inc. Iron River, Mich.; WJPD Inc., Ishpeming, Mich. (Complainants) v. Michigan Bell Telephone Co., Detroit, Mich. (Defendant).

Docket 18509 - In the Matter of Applications of Telephone Companies for Section 214 Certificates for Channel Facilities Furnished to Affiliated Community Antenna Television Systems.

Docket 17333 - In the Matter of General Telephone Company of California, The Associated Bell System Companies. The General Telephone System and United Utilities, Inc. Companies - Applicability of Section 214 of the Communications Act with Regard to Tariffs for Channel Service for Use by Community Antenna Television Systems.

Docket 17441 - In the Matter of Better TV Inc. of Dutchess County, N. Y., Complainant v. New York Telephone Co. Defendant. In Re Applications of New York Telephone Co. for Certificates of Public Convenience and Necessity for Construction and/or Operation of CATV Channel Distribution Facilities to Provide Service to U.S. Cablevision Corp., in the General Vicinity of Hyde Park, N. Y. (Docket

18525, File No. P-C-7271) Comtel, Inc., in the Borough of Manhattan, New York City, N. Y. (Docket 18620, File No. P-C-7226) Brookhaven Cable TV Inc., in the General Vicinity of Brookhaven, N. Y. (Docket 18624 File No. P-C-7282) Comtel Inc., in the Borough of Manhattan New York, N.Y. (Docket No. 18750 File No. P-C-7430).

Cable TV

Documents From 1968 CID #1002

<u>AT&T</u>	<u>C&P Hdqtrs</u>	<u>Bell of PA</u>	<u>Northwestern Bell</u>
110	102	105	017
126	200		018
013	203	<u>MTN States Tel</u>	
107	79		<u>New York Tel.</u>
007		046	
060	<u>C&P W. VA</u>	039	027
025		145	008
013	063	040	129
071	079	046	
080	140		
118		<u>Michigan Bell</u>	<u>Pacific Tel.</u>
009	<u>C&P VA.</u>		
072		016	1276
034	080	135	656
051		020	478
128		047	787
041		112	128
114		103	
044		111	
		119	
<u>New England Tel.</u>		<u>South Central Bell</u>	<u>So. New Engl. Tel.</u>
122		142	010 069
123		227	056 074
048		086	045 089
		138	048 091
		375	081 027
			044 016
			040 031
<u>Southwestern Bell</u>		<u>Southern Bell</u>	
046		038	041 092
246		046	063 094
025		044	066 013
070		357	068 079
		013	070 029

Documents From 1974 CID #1570

A 1119A 1-7-190
 A-156 1-7-104

Third Party Documents

Relied on documents provided by National Cable Television Association (NCTA)

Specific document cited:

NCTA 786
 NCTA 131

Relied on documents in connection with TV Signal of Aberdeen v. AT&T Co. and Northwestern Bell - Civil Action No. 70-6N (S.D.) (Need AT&T documents associated with the case)

Other

1966 - Cable contract of Pacific Northwest Bell.

Some limited further discovery may be required.

J. Exclusion of Potential Competition from New Independent Telephone Companies

Although local telephone service is provided on a monopoly basis, there is still competition to determine who will install telephone service to new, developing areas. AT&T and the Bell operating companies attempt to discourage this form of competition, and prefer to enforce territorial divisions. The proliferation of non-Bell telephone service in suburban areas would, over time, dilute their share of total telephone service. However, where developers of new communities are dissatisfied with the price or quality of service proposed to be provided by the local Bell operating company, or where the local Bell operating company initially refuses to provide any requested telephone service, the developers or residents may attempt to contract elsewhere for telephone service. In these circumstances, control over access to the existing telephone network provides AT&T and the Bell operating companies with the power and incentive to obstruct the development of these new independent companies. Since telephone service is virtually a necessity for most people, refusing or even delaying access to the network is sufficient to force the new communities to use the service of the local Bell operating company.

Section 214 Certificates

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F.C.C. 19-115

BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

In the Matter of
 APPLICATIONS OF TELEPHONE COMPANIES FOR
 SECTION 214 CERTIFICATES FOR CHANNEL
 FACILITIES FURNISHED TO AFFILIATED COMMUNITY ANTENNA TELEVISION SYSTEMS } Docket No. 18509

FINAL REPORT AND ORDER

(Adopted January 28, 1970)

BY THE COMMISSION: COMMISSIONERS ROBERT E. LEE AND WELLS
 ABSENT; COMMISSIONER JOHNSON CONCURRING IN THE RESULT.

BACKGROUND OF PROCEEDING AND SUMMARY OF COMMENTS

1. This proceeding was initiated by the Commission on its own motion by a notice of inquiry and notice of proposed rulemaking (notice) released April 4, 1969 (34 F.R. 6290). The precipitating factor underlying the notice was the filing of 17 formal applications by telephone companies which sought authority under section 214 of the Communications Act to construct or operate, or to construct and operate channel facilities to be furnished under a published tariff to a community antenna television system (CATV). In all said applications there existed some degree of ownership affiliation between the telephone company applicants and the CATV customers to be served.¹ The Commission believed that these pending applications raised certain significant policy or legal questions that should be resolved by the Commission before those applications could be considered in other respects. Foremost among such questions was whether telephone companies, either directly or through their owned or controlled affiliates, should be permitted to engage in furnishing CATV service to the public and, if so,

¹ Subsequent to the adoption of the notice, certain alleged factual misstatements in the notice were brought to the attention of the Commission. Continental Telephone Corp. (Continental) in its comments stated that the number of homes served by Continental totaled 28,363 as of Mar. 21, 1969, and were provided by Continental's five CATV subsidiaries which operate in 44 communities in 10 States. The General Telephone Co. of the Midwest, formerly General Telephone Co. of Missouri, requested that its application for authority to construct CATV in the city of Columbia, Mo. (File No. P.C. 7234) be severed from this proceeding. It appears that, although applicant's contemplated customer was G.T. & E. Communications, Inc. at one time, this was no longer the case as of the date the notice was released. Applicant actually proposed to furnish wide spectrum service to CATV of Columbia, Inc., an unaffiliated operator. At the time Southern Bell Telephone and Telegraph Co. applications (File Nos. P.C. 7235, 7234, and 7233) were filed, Jefferson-Carrollan was equally owned by Jefferson Standard Broadcasting Co. and Carolina Telephone & Telegraph Co. and Southern Bell owned approximately a percent of the stock of Carolina. This 1 percent interest was purchased by United Ediffices, Inc., shortly before the notice was issued. However, these alleged factual misstatements are not material to our decision herein.

what conditions should be attached to any authorizations therefor issued by the Commission under section 214 to such companies to insure that rendition of the service would serve the public convenience and necessity.

2. Accordingly, we invited comments addressed to, but not necessarily limited to, the following questions and issues:

(a) What effect, if any, would the existence of Commission policies in this area have upon the Commission's expressed long-range concern about a common carrier acting as a program originator?

(b) What effect would Commission policies regarding ownership relationship between CATV and communications common carriers have upon the concentration of control of CATV systems?

(c) Should the Commission adopt specific policies and regulations to protect against any potential unfair or anticompetitive practices that might arise as a result of the affiliated relationship between telephone companies and CATV systems? In this connection, consideration should be given to potential problems as:

(i) possible discriminatory treatment between affiliated and nonaffiliated CATV systems in the construction or furnishing of CATV facilities;

(ii) possible unfair competitive advantages that the affiliates of telephone companies may have over nonaffiliated entities of establishing CATV systems;

(iii) the possibility that telephone companies might subsidize the cost of construction and services required by their affiliates out of revenues derived by the telephone companies from their other services, thereby resulting in the underpricing or undercosting of services furnished by the affiliates, to the competitive detriment of nonaffiliated CATV systems;

(iv) the possibility that ownership affiliation might unduly constrain the full development of non-TV CATV services (e.g., data services) that could be substituted for traditional telephone services.

(d) Should the Commission adopt specific policies and regulations to protect against potential detrimental effects upon regular telephone consumers occasioned by telephone company supply of CATV service to affiliated companies. In this connection, consideration should be given to such questions as:

(i) Will the telephone company's investments in an affiliated CATV system enhance or impair its ability to raise the capital necessary to expand and improve services required by the regular customers of the telephone company?

(ii) How will the overall risk condition of the telephone company and its cost of capital be affected by investments in CATV systems?

(iii) To what extent will the telephone company's requirement to supply specialized services to its CATV affiliates be in conflict with its requirements to furnish new or expanded services and facilities to its regular customers for such services as wide spectrum and video telephone switched services?

Section 211 Certificates

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(iv) How will telephone company ownership affiliation with CATV systems affect the policies, programs, priorities, and decisions of investment in facilities and research and development that are undertaken by the telephone companies?

(e) Will there be (and to what extent) cases where a substantial segment of the public would be deprived of CATV service unless a telephone company is permitted to furnish facilities to an affiliate?

(f) How should Commission policies in regard to affiliated CATV's take into account the legitimate role of local or State governmental agencies in their choice of who should be licensed or franchised to be CATV operators?

(g) What effect would Commission policies in this area have on the incentives for CATV operators to operate also as common carriers on any of their channels not utilized for carriage of broadcast signals or CATV origination?

(h) What effect will Commission policies (or the lack thereof) in this area have upon incentives for CATV program origination in the interest of meeting local public needs?

(i) Should the Commission prohibit telephone company ownership affiliation with CATV's, or, alternatively, what conditions might be imposed on certificates granted in affiliation cases to further the public interest objectives of the act?

(j) Should the Commission impose policies or conditions retroactively (and if so, in what nature) on presently operating telephone company-affiliated CATV systems that are not now the subject of section 211 applications?

5. We also requested the participants to consider in their comments, and to appropriately discuss the policy implications, if any, of proposals to provide "wide spectrum" services under published tariffs, as contrasted with the proposals to serve only CATV customers, and further "put all interested persons on any notice that rules may be adopted incorporating any general policies established herein", in case the Commission determines as to some of the policy questions here involved, that they should be embodied in the rules.

6. Comments were subsequently filed by the National Businessmen's Council (NBC); General Electric Co. (GE); T-V Transmission, Inc. (T-V Transmission); Continental Telephone Corp. (Continental); Conestoga Telephone and Telegraph Co. (Conestoga); Enterprise Telephone Co. (Enterprise); Cox-Cosmos, Inc.; Commonwealth Telephone Company (Commonwealth); American Telephone & Telegraph Co. (A.T. & T.); National Association of Educational Broadeners (NAEB); Radio Hanover, Inc.; National Association of Regulatory Utility Commissioners (NARUC); National Cable Television Association, Inc. (NCTA); United States Independent Telephone Association (USITA); California Community Television Association (CCTA); United Telephone System (United); Mid-Continent Telephone Corp. (Mid-Continent); G.T. & E. Service Corporation (G.T. & E.); Americans for Democratic Action (ADA); United States Department of Justice (Justice). Joint comments were filed on behalf of Columbia Cable System, Inc., Daniels and Associates, Inc., GenCor, Inc., H&B American Corp., TelePrompter Corp. and Twin County

Trans-Video, Inc. Reply comments were submitted by NABF, Continental, A.T. & T., United, G.T. & E., USITA, Oxnard Cablevision, Inc. (Oxnard), and the city of New York (New York).

5. For purposes of clarity we have decided to first set forth the overall positions taken by those filing comments and then, to the extent possible, the responses to the specific issues and questions set forth in the notice and paragraph 2, *supra*.

POSITION OF THE TELEPHONE INDUSTRY

6. The overall concern of the telephone companies filing comments in this proceeding is that their industry's future ability to provide total communications services, including CATV, vis-a-vis their wide spectrum service offerings, will be jeopardized or limited. Their position, in this respect, is supported by the ADA and the National Businessmen's Council. The latter in its policy guidelines to the Commission urges that "all telephone companies must have equal opportunities to supply the total carrier services, including CATV."

7. In addition to addressing some of the individual issues raised in the inquiry, the industry has generally questioned the Commission's authority to preclude telephone companies' ownership of CATV systems or their leasing of facilities to affiliated CATV systems. They, together with NARUC, urge the Commission to defer to State and local regulation in these areas, and object to being "singled out" for special conditions or restrictions, as distinguished from other owners of CATV systems.² Aside from questioning the Commission's authority, under antitrust or other statutory provisions, to restrict affiliation between telephone companies and CATV systems, the telephone companies allege the lack of any factual basis for the need of any new or additional regulatory intervention by the Commission. They allege their nondiscriminatory treatment of independent CATV systems; emphasize the fact that telephone company-CATV common ownership is not statistically significant in the total national CATV field; and allege instead that greater affiliation between the two would actually increase the desirable diversification of communications media.

8. The members of the industry have generally agreed on the desirability, if not the essentiality, of the telephone companies providing economic and technical support to many CATV systems in rural and/or sparsely populated areas. The telephone companies contend that because of the limited economic potential involved, there is generally no interest by independent CATV systems in investing in cable systems in such areas, with the only result that, unless affiliation with the local telephone company is permitted, a significant portion of the country's population would be deprived not only of CATV service, but the future services to be provided by coaxial cable communication systems.

9. The carriers minimize the effect of telephone company-CATV system affiliation on the Commission's expressed long-range concern

² This view is shared by Bell which argues that any conditions the Commission may ultimately impose should be "totally confined to the subject of fair and nondiscriminatory treatment as between affiliated and nonaffiliated customers of the telephone companies."

about a common carrier acting as a program originator. It is the carriers' position that their affiliated CATV systems are separate entities acting independently from their affiliated telephone companies. Further, the carriers point out any applicable rules, presently in effect or those which may result from docket No. 18397, would apply to all CATV systems which originate programming, regardless of system ownership.

10. In discussing the provision of pole space to CATV systems, several of the telephone companies insist that such equipment is "strictly private property," and that the telephone companies are under no obligation to make space available to CATV systems on their poles.

THE POSITION OF THE INDEPENDENT CATV SYSTEMS

11. The independent CATV operators are opposed to any form of telephone company ownership affiliation with CATV systems. They contend that there is no reason for the Commission to authorize a telephone company to construct CATV channel distribution facilities for its own subsidiary unless, in the particular area, no independent CATV entrepreneur was willing to enter the field. The independent CATV systems contend however, that in virtually all cases in which a telephone company would wish to offer CATV services, an independent CATV operator would be equally willing to provide those services. Radio Hanover states that "given a sufficient period of time," there will be "independent CATV interest in almost any community upon which the telephone companies have designs."

12. Most of the independent systems ask that the Commission consider relevant antitrust policy in deciding this matter. In the joint comments of Columbia Cable Systems, et al., the allegation is made that the telephone companies' "power to exclude competition" *** coupled with the purpose or intent to exercise that power" is in violation of the Sherman Act, and that "the telephone companies' restrictions relating to CATV pole attachments fall squarely within the type of restriction struck down in *Carterfone*."

13. In all cases, the independent CATV operators contend that the very existence of a monopoly as powerful as that of the telephone company suggests a great potential for abuse of that monopoly. They cite various anticompetitive practices in which, they claim, various telephone companies currently engage, such as:

(a) Telephone companies with CATV affiliates can subsidize those affiliates with revenues obtained through telephone company operations. The CATV operators suggest that this may impair the quality of regular telephone services offered;

(b) Telephone companies can arbitrarily refuse to grant pole space to independent CATV systems for the placing of their own cable facilities, thus virtually barring them from entering into competition with a telephone company affiliate. The joint comments submitted by Columbia Cable Systems, et al., relate this practice to antitrust policy, stating that since telephone poles are constructed on public rights of

* 47 F.C.C. 2d 129.

way, any anticompetitive act in relation to those poles is an abuse of the public trust;

(c) Telephone companies can rely upon their long-established relationships with community leaders to compete unfairly for available CATV franchises;

(d) Telephone companies can exert pressure upon independent CATV entrepreneurs in an attempt to force them to accept expensive lease-back arrangements;

(e) Rates charged by telephone companies for pole attachment or broad-band cable are often quite unrelated to the cost of providing such a service;

(f) Telephone companies can arbitrarily impose restrictions upon the uses to be made of broad-band cable attached to telephone poles.

11. The independent CATV systems, in addition to these allegations of unfair practices, point out two of the broader consequences of telephone company-CATV affiliation. First, they contend that if affiliation is allowed, the CATV industry will eventually fall under the control of a few large telephone companies, making competition virtually nonexistent; and, secondly, they feel that, with the absence of substantial competition, program origination and the general quality of CATV programming will decline.

15. It is their contention that among the advantages to be obtained by restricting telephone company-CATV affiliation is the substantial technological improvements in service that would result from vigorous competition, and the improvement in the quality of programming and in the amount of program origination that would also result.

16. All of the independent CATV systems propose that the Commission establish regulations requiring telephone companies to offer pole attachment arrangements to CATV systems when the attachment of additional cable is physically possible, and further ask that the Commission determine reasonable rates for the provision of such a service. These independent systems also recommend against the grant of exclusive CATV franchises in a particular area. Most of the CATV operators feel that the granting of franchises should be left in the hands of local authorities, but the National Association of Educational Broadcasters (NAEB) and Radio Hanover suggest that Federal intervention might be helpful, insofar as it could protect the public from extensive "cross-media" ownership, and compensate for the variety (and varying sophistication) of local authorities.

17. In addition to the above, NCTA proposes that stringent restrictions be imposed upon the granting of section 214 certification of telephone company constructed CATV facilities. It suggests that certification be denied in instances where it can be established that a telephone company has competed unfairly for a franchise; that telephone companies with policies of refusing pole line attachments to independent CATV operators be completely barred from CATV operations; that there be a substantial notice period, during which the availability of a franchise is announced and publicized, before the granting of section 214 certification; and that the Commission issue regulations insuring expeditious repairs to the systems constructed by independent CATV operators via pole line attachment agreements,

and preventing overbuilding of CATV facilities by telephone companies.

18. The independent CATV operators also ask that any restriction the Commission should decide to impose should be imposed retroactively, since telephone companies were well informed that, if they were to construct CATV facilities, such construction would be at their own risk.

COMMENTS OF OTHER PARTIES

19. NABF proposes that the Commission establish four priorities of service, or channel usage, to be adhered to by all CATV systems, and that operators be required to meet the conditions of each of these categories of service before allocating channels to the next lower category:

(1) Television station signal carriage.

(2) Requirements imposed by State or local franchising authorities.

(3) One or more channels available on a free or reduced rate basis for local noncommercial educational and public service programming.

(4) General common carrier usage (as contemplated by paragraph 26 of the rulemaking notice in docket IS-297).

20. NABF also feels that a common carrier is a specialist in distribution and, as such, should not be permitted to function as a program originator. In the matter of "wide spectrum" offerings, NABF feels that telephone companies should be allowed to offer "wide-spectrum" services only if no independent operator is willing to do so. NCTA feels that "wide-spectrum" tariff offerings are unfair in any case, since they do not comport with common carrier responsibilities to offer specific services. It describes the telephone companies' desire to offer "wide-spectrum" services as "a blatant attempt to control all uses of broad-band cable."

21. *The National Businessmen's Council* advocates a universal, wide-band, switched network carrier system which would be franchised, operated, and regulated consistent with common carrier public utility principles, and that all telephone companies should have equal opportunity to supply the total communication services, including CATV. The proposed system should have capabilities for point to multiple point total switching freedom. It further proposes that the carrier system may not control content or equipment manufacturing; that the content services may not control the carrier or equipment interests; and that the carrier system may not restrain users in any way, except as to reasonable safeguards of technical operations.

22. *Americans for Democratic Action* calls for a public utility common carrier structure, analogous to the telephone system, which will make access and use of the system available to any and all customers at reasonable rates. It proposes that such a system prohibit the carriers from engaging in the supply of content of broadcast matter. ADA also suggests that development of a national broad band, two way switched carrier system, modeled on the telephone dial and exchange system, with freedom from restrictions on content and programs. It believes that common carriers must not be denied entry into the carriage of cable television, since the Consent Decree, which has barred

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A.T. & T. from broadcasting, "is not relevant to common carrier services."

23. *Justice* believes that there is a serious danger that the existing local monopoly position of the telephone companies as communications common carriers may prevent the development of an independent CATV industry. It specifically recommends that the Commission use its section 214 authority (1) to require telephone companies to offer pole space, or conduit space, to all applicants on equal and nondiscriminatory terms; (2) to prohibit the telephone companies from restricting a CATV operator's use of cables, except as shown to be necessary to protect the technical integrity of the communications network; (3) prohibit telephone companies' direct offering of CATV services as part of their telephone tariff; and (4) allow telephone companies to establish separate CATV affiliates, provided they offer no CATV service in any territory served by the parent company, "subject to a possible exception for remote areas." *Justice* also urges that until and unless the Commission is satisfied that the above measures, or any others, if necessary, are adequate to deal with the type of competitive problems involved here, it should not entertain any more 214 applications by telephone companies to construct CATV and other "wide-spectrum" facilities. To assure the public interest be best served by having built the most efficient broad-band cable system by either the telephone company or the independent CATV operator, *Justice* suggests that the Commission under section 214 should not authorize telephone companies to build such systems unless there is a showing that (1) a properly franchised or authorized independent CATV operator has entered into a leaseback arrangement with the telephone company; (2) pole or conduit space was available to the franchised CATV operator if he would have preferred to construct his own system; and that (3) the resulting system would be as efficient as, and have as much capacity as, those proposed by independent CATV operators serving comparable communities. *Justice* further recommends that in order to avoid "permitting a regulated utility to carry on nonregulated functions, * * * the Commission should consider adopting a rule recognizing the right of a telephone company to establish separate segregated CATV affiliates, provided they offered no service in any territory served by the telephone company," with "some limited exceptions in certain circumstances involving remote communities," where no reasonable alternative system exists at present or in the foreseeable future.

24. An issue-by-issue outline of the various representative comments follows:

(a) *What effect, if any, would the existence of Commission policies in this area have upon the Commission's expressed long-range concern about a common carrier acting as a program originator?*

25. As heretofore indicated, the telephone companies do not believe that the existence of Commission policies in the area of CATV-telephone company affiliation would have any effect upon the Commission's expressed long-range concern about a common carrier acting as a program originator. They submit that their affiliated CATV operations are offered by separate entities, and that any generally applicable

rules would apply to all CATV systems, irrespective of system ownership. The independent CATV interests, the National Businessmen's Council, ADA, and Justice express concern over the possible adverse consequences of telephone company control of CATV program content or program origination. On the other hand, NABF argues that CATV systems should not be allowed to originate programs at all, pointing out that the history of the networks and of the motion picture industry shows that common ownership of production and distribution facilities is bad public policy, and that program origination, certainly in the educational television field, requires special expertise, not generally possessed by CATV systems.

(b) *What effect would Commission policies regarding ownership relationships between CATV and communications common carriers have upon the concentration of control of CATV systems?*

26. The telephone companies question the Commission's power as well as the existence of any proved need for adopting special policies regarding ownership relationships between CATV and communications common carriers, which would affect the concentration of control of CATV systems. They proclaim their nondiscriminatory attitude towards the independent CATV operators; emphasize the fact that telephone company-CATV common ownership is not statistically significant in the total national CATV field; and explain that more such affiliation would actually increase the desirable diversification of communications media. The independent CATV operators believe that if affiliation between telephone companies and CATV is permitted, the CATV industry will eventually fall under the control of a few large telephone companies, thus preventing the various technological and quality improvements that would result from free competition. Justice contends that there is a serious danger that the existing local monopoly position of the telephone companies as communications common carriers may prevent the development of an independent CATV industry. It illustrates the alleged danger of telephone company monopolization by citing *Radio Hanover v. United Utilities, Inc.*, 273 F. Supp. 709 (M.D. Pa. 1967).

(c) *Should the Commission adopt specific policies and regulations to protect against any potential unfair or anticompetitive practices that might arise as a result of the affiliated relationship between telephone companies and CATV systems?*

(i) *Possible discriminatory treatment between affiliated and non-affiliated CATV systems in the construction or furnishing of CATV facilities.*

27. The telephone companies maintain, as typified in the comments of G.T. & E., that they do not engage in any unfair or anticompetitive practices, and that, in any event, section 202(a) of the Communications Act provides adequate protection. The independent CATV interests and Radio Hanover argue, in effect, that telephone companies with affiliated CATV systems would be incapable of competing fairly with nonaffiliated CATV's, and therefore, adoption of specific policies and regulations by the Commission is necessary. CCFA, among others, urges that regulatory surveillance should extend to all aspects of the CATV-telephone company relationship, specifically focusing on pole

attachment agreements, their conditions and rates, and on situations of direct competition between affiliated and nonaffiliated CATV's. NCTA and Justice, in supporting the view for the need for such protective policies, enumerate various alleged abuses by telephone companies, and conclude that the Commission should require telephone companies to offer pole space to all applicants on equal terms, provided the attachment of additional cable is physically possible, and should prohibit telephone companies from restricting a CATV system's use of CATV distribution facilities.

(ii) *Possible unfair competitive advantages that the affiliates of telephone companies may have over nonaffiliated entities in establishing CATV systems.*

28. T.V. Transmission and G.T. & E. allege that their affiliates do not have any unfair competitive advantages in establishing CATV systems. Furthermore, they claim only limited success in competing for franchises on the local level, pointing to statutory regulations pertaining to local CATV franchising. NCTA, expressing the view held by the independent CATV systems, argues that the telephone companies have made it clear that the CATV system who chooses to use telephone company provided distribution facilities will be the first one in the field. It is further alleged that in the event of damage to facilities, the telephone company, in restoring service, is free to prefer the affiliated over the independent CATV system. Cox-Cosmos alleges that CATV systems often experience delay when requesting telephone companies to engage in "make ready" work so that the independent CATV system may place its facilities on the utility poles.

(iii) *The possibility that telephone companies might subsidize the cost of construction and services required by their affiliates out of revenues derived by the telephone companies from their other services, thereby resulting in the underpricing or undercosting of services furnished by the affiliates, to the competitive detriment of nonaffiliated CATV systems.*

29. NCTA comments that "it is theoretically possible for the integrated telephone company-CATV complex to set tariff rates in a delicate balance sufficiently high to cause substantially reduced profitability for CATV's while setting not so high as to induce lease-back takers to withdraw from the lease-back and go to the very expensive expedient of an all underground system." CCTA, underscoring the risk of such anticompetitive policies by telephone companies, adds that they could transfer funds quite easily and that such practices would be almost impossible to uncover under the present methods of analysis and evaluation. The telephone companies deny the existence of such anticompetitive subsidization; claim that there are no funds transferred from telephone to CATV operations; and that the services rendered by a telephone company to its CATV affiliate are pursuant to validly filed tariffs.

(iv) *The possibility that ownership affiliation might unduly constrain the full development of non-TV CATV services (e.g., data services) that could be substituted for traditional telephone services.*

30. As to the possibility of any undue constraint by telephone company affiliated ownership on the full development of non-TV CATV

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services (e.g., data services) which could be substituted for traditional telephone services. G.T. & E., as indicative of the industry position, considers such a possibility as remote, and Continental contend that in view of the fact that the majority of CATV systems are not affiliated with telephone companies, indicates that there should be ample opportunity for the development of non-TV CATV services. Some telephone companies with CATV affiliates point out that this issue is under consideration in docket No. 18397, and that until sufficient information is before the Commission concerning the technological, market, and regulatory development, in this area the Commission's concern is premature. T.V. Transmission asserts that telephone company-affiliated CATV operations will foster improvements in telephone service or substitutions therefor, as a result of the continuing research and development being undertaken by telephone companies to improve such service.

(d) *Should the Commission adopt specific policies and regulations to protect against potential detrimental effects upon regular telephone service customers occasioned by telephone company supply of CATV services to affiliated companies?*

(i) *Will the telephone company's investment in an affiliated CATV system enhance or impair its ability to raise the capital necessary to expand and improve services required by regular customers of the telephone company?*

31. The telephone companies deny the need for any specific policies or regulations in this area, alleging that present agencies provide enough protection against such problems. G.T. & E. states that its CATV subsidiary, G.T. & E. Communications, is financed through loans from its parent company, which, in turn, obtains its capital through sale of securities to the public. On the other hand, Cox-Cosmos, reflecting the general view of the independent CATV operators, believes that there is a real possibility that a telephone company might subsidize the cost of CATV construction with other telephone company revenues. Justice believes that it is necessary to prohibit any telephone company from offering CATV services to the public directly as part of its rate-regulated telephone undertaking, in order to prevent any problems of cross-subsidy between the telephone company's regulated and unregulated business.

(ii) *How will the overall risk condition of the telephone company and its cost of capital be affected by investments in CATV systems?*

32. Enterprise and Conestoga, two rural telephone companies, submit that telephone services potentially benefit from CATV ownership since the assets of a thriving CATV subsidiary make the telephone company itself a better risk for investors. G.T. & E. contends that, if the Commission were to put CATV operators into direct competition with telephone companies in furnishing communications service to the public, the cost of capital to the telephone companies would rise, since investors would view them as substantial risks. It claims that this increased cost would ultimately be borne by the telephone company's ratepayers.

(iii) *To what extent will the telephone company's requirement to supply specialized services to its CATV affiliates be in conflict with its*

requirements to furnish new or expanded services and facilities to its regular customers for such services as wide spectrum and video telephone switched services?

33. G.T. & E. comments that channel service offerings by a telephone company to a CATV affiliate under valid tariffs are merely another form of communications service offered to the public by an operating telephone company, and thus there is no conflict between the offered services. Justice, however, warns that since a primary responsibility of the Commission is to foster innovation and efficiency in the communications industry, it cannot allow those with vested interests in existing technology and services to forestall and limit the growth of new services and better technology based on broadband facilities.

(iv) How will telephone company ownership affiliation with CATV systems affect the policies, programs, priorities and decisions of investment in facilities and research and development that are undertaken by the telephone companies?

34. As to the effect of telephone company ownership of CATV systems on the policies, programs, priorities, and decisions of investment in facilities and research and development that are undertaken by the telephone companies, G.T. & E. states that the research and development of the General System is carried on by employees of its subsidiaries, other than G.T. & E. Communications. Accordingly, telephone company affiliation will have no effect on the policies, programs, priorities, etc., of the general system. CCA, on the other hand, insists that diversion of telephone company investments into CATV must result in a dissipation of a telephone company's ability to expand and improve its prime common carrier services. Further, construction of CATV channel facilities by telephone companies might be wasteful duplication of services if such facilities can be more economically provided by local independent CATV operators who, unlike the telephone companies, would not be inclined to overbuild. Justice in its comments also proposes measures conducive to assuring that the cable facilities will be built by the most efficient party and to safeguard against the construction by telephone companies of "uneconomic or technically less advanced systems to forestall independent entry."

(e) Will there be (and to what extent) cases where a substantial segment of the public would be deprived of CATV service unless a telephone company is permitted to furnish facilities to an affiliate?

35. The independent CATV operators, along with Radio Hanover, allege that "there are sufficient numbers of independent CATV companies to insure that there will be a substantial number of applicants for CATV franchises in all communities which show promise of return," and that "there is no reason to expect that telephone companies will seek to provide service in any area found unattractive by independent CATV's." CCA adds that since there has, thus far, been no dearth of independent CATV applicants, the hypothetical possibility that such a situation might occur is hardly a reason to authorize the telephone companies' entry into the field. The telephone companies, General Electric, and NARUC, take the position that, in some rural areas, the only entity for whom the operation of a CATV installation would be economically feasible might be the local tele-

phone company. G.T. & E., for one, alleges that in some sparsely populated areas of the country, people may be deprived of not only CATV service but also other coaxial cable services unless telephone company affiliates provide such service. Justice agrees that in the event it becomes the Commission's policy to prohibit CATV-telephone company ownership affiliation, it may become necessary to provide for exceptions to this general policy in rural areas.

36. Virtually all of the parties responding to the notice agreed that it is in the public interest for CATV systems to comply with local or municipal franchising requirements. The telephone companies and NARUC strongly argue that local authorities are best equipped to understand the problems of CATV in a given area. NCTA asks that "safeguards * * * be taken to assure that such requirements are not circumvented by telephone company-affiliated CATV operations." Cox-Cosmos requests that the Commission prohibit the granting of exclusive franchises, and also asks that the Commission make it clear to local authorities that an unaffiliated franchise holder would suffer no discrimination with respect to the telephone company's transmission facilities or their construction. The joint comments of several independent CATV operators question the wisdom of leaving control of franchising completely in the hands of local authorities, as a local telephone company occupies a position of advantage with local authorities, since it can guarantee that its affiliated CATV system will be promptly serviced, while an independent CATV operator can make no such claim. Radio Hanover believes that for purposes of national uniformity, the Federal Government may properly curtail absolute franchising freedom.

(f) *What effect would Commission policies in this area have on the incentives for CATV operators to operate also as common carriers on any of their channels not utilized for carriage of broadcast signals or CATV origination?*

37. The telephone companies agree that the undertaking by CATV systems of common carrier services would be improper, and that to encourage the CATV systems to compete with telephone companies on these services would not be beneficial to the public interest. Conestoga and Enterpriso state that they have the incentive and the know-how to encourage their respective cable companies to utilize vacant channels on a common carrier basis if that development becomes technologically or economically feasible. Under their limited circumstances, however, such services would not be feasible for either the telephone companies or their subsidiaries, acting alone. The NABF assumes that some CATV channels would be allocated for general common carrier usage (as contemplated by par. 26 of the rulemaking notice in docket No. 18397). Cox-Cosmos proposes that the Commission not classify CATV systems as common carriers, since they are not public utilities.

(h) *What effect will Commission policies (or the lack thereof) in this area have upon incentives for CATV program origination in the interest of meeting local public needs?*

38. The telephone companies take the position that incentives for origination should not depend on who owns the CATV installation. G.T. & E. contends that Commission policies regarding affiliation

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should have no effect upon origination but that, should origination be required, the telephone company-affiliated CATV systems, unlike those affiliated with news or entertainment media, would not be confronted with conflicting interests. Continental adds that local programming is one of the major attractions of CATV, and the support given to it will provide sufficient incentive for program origination. The independent CATV systems feel that the lack of Commission policies prohibiting CATV-telephone company ownership affiliation could have a somewhat detrimental effect on local program origination. They claim that "there has been little indication to date of innovation in the area of originations on the part of CATV systems affiliated with telephone companies"; further, they feel that, since "telephone company interest in control of cable was defensive in origin," the interest of telephone company-affiliated CATV systems in program origination might also be defensive, and hence minimal.

(i) *Should the Commission prohibit telephone company ownership affiliation with CATV's, or, alternatively, what conditions might be imposed on certificates granted in affiliation cases to further the public interest objectives of the act?*

32. The independent CATV systems and Radio Hanover unanimously oppose telephone company ownership affiliation. Columbia Cable Systems, Inc. et al., contend that it is in the public interest that affiliation be prohibited, since such prohibition would enhance CATV competition and encourage telephone companies to engage in the improvement of their telephone service. Cox-Cosmos opposes affiliation because it feels that, by owning CATV systems, a common carrier is negating its responsibility to treat all customers equally. Radio Hanover believes that the prohibition of telephone companies' ownership of CATV is justified since, on the basis of their past performance, the indications are that existing safeguards against the preferential treatment of telephone company affiliates will almost certainly be insufficient. NCTA also opposes affiliation, but states that "if the Commission should, contrary to our most strenuous urging, consider granting section 214 certificates in certain cases to companies such as United or General * * * the Commission should require most stringent conditions upon such section 214 authorizations, and would be entirely justified * * * in imposing restrictions going beyond those required for smaller independent telephone companies." NCTA's position is that "the Commission should flatly prohibit all telephone company affiliation with CATV systems. Such a regulatory policy would at one sweep resolve many of the inherent problems caused by telephone company proprietary participation in CATV." In the alternative, it proposes prohibition of affiliation in areas where they already conduct regular telephone operations. The positions of the telephone companies are varied, but they are unanimous in their belief that the Commission would not be justified in taking steps to prohibit affiliation. A.T. & T. feels that it is not in the public interest for the Commission to regulate affiliation, and feels that the Commission's role should be that of insuring nondiscriminatory treatment to both affiliated and nonaffiliated customers of the telephone company. G.T. & E. alleges that, since "no concrete evidence has thus far been presented to indicate

that such affiliation is wrong or is in any way harmful to the public," there is no necessity for the prohibition of affiliation. T-V Transmission believes that the provision of CATV service is a natural extension of the communications business, and that affiliation therefore ought to be encouraged. Mid Continent states that there is no factual or legal basis for the adoption of rules enforcing the prohibition of affiliation. Enterprise feels that the Commission should direct its attention to specific unfair practices, not to ownership affiliation in its totality. Justice suggests that the Commission should permit telephone companies to set up separate segregated CATV affiliates, so long as they offer no CATV service in areas served by the telephone company itself. It also suggests that exceptions to such a policy might be made in remote rural areas. Further, Justice states that, as long as there is no limitation imposed by telephone companies on pole attachment rights, there is no need to preclude the construction of CATV facilities by telephone companies. It, however, pole space is limited, Justice recommends that the Commission should not authorize telephone companies to construct CATV channel facilities unless (a) some franchised CATV operator has entered into a leaseback arrangement with the telephone company, (b) pole space was available to him as an alternative to leaseback, and (c) the resulting system would be as efficient as those proposed by independent CATV operators in comparable communities. GE believes that outright prohibition of the subject affiliation would be detrimental to the public interest because a significant portion of the rural segment of the country's population could be deprived not only of CATV service, but also of the other future benefits of coaxial cable communication systems unless telephone companies and their affiliates are permitted to furnish such systems on a common basis, at low cost. Conestoga and Enterprise comment that, in case such a prohibition is decided upon, the Commission "grandfather" existing ownership situations at least in those circumstances where no allegations of any abusive practices on the part of the telephone company have been made, or can be rebutted. For extension of existing CATV service, they recommend that any additional authority be made subject to any appropriate new Commission policies adopted to prevent discriminatory practices favoring telephone company affiliates.

(j) *Should the Commission impose policies or conditions retroactively (and if so, of what nature) on presently operating telephone company affiliated CATV systems that are not now the subject of section 214 applications?*

10. Cox Commos proposes the Commission should require divestiture by telephone companies within 1 years from the date of order in this proceeding. T-V Transmission, reflecting the viewpoint of the telephone industry, states that in view of the very significant capital investments made by the telephone companies, the imposition of such retroactive policies would be "inappropriate, inequitable, and potentially amounting to confiscation." Radio Hanover disagrees, and contends that in view of the Commission's "repeated and early warnings about unlawful uncertificated cable construction, it would be unconscionable to permit grandfathering considerations to interfere with

just determinations in the public interest." NCTA agrees essentially with Radio Hanover's comments that the more than adequate warning given to telephone companies engaged in the construction of CATV facilities justifies retroactively.

41. With respect to applications for certificates to construct or operate channel facilities that will be used to provide wide-spectrum services under published tariffs the telephone companies' view is typically reflected in the comments of Commonwealth Telephone Co., which recommends that the Commission should encourage telephone companies to offer wide-spectrum services under published tariffs. In G.T. & E.'s opinion, the furnishing of such services is an obligation to all customers, CATV or non-CATV, affiliated or not. It asserts that the public interest requires the permission of joint use by customers of common carrier facilities without regard to the nature of the carried traffic. Cox-Cosmos would allow wide spectrum service offerings (excluding CATV) by telephone companies only where no unaffiliated CATV system is interested. NCTA insists that "wide-spectrum tariff offerings are * * * unreasonable in themselves," because they constitute an offering to lease portions of cable spectrum for undisclosed purposes, thus, their tariffs fail to comport with common carrier responsibilities to offer specific services. Furthermore, these offerings, NCTA believes, constitute a blatant attempt to control all uses of broadband cable and could give rise to discriminatory, unjust and unreasonable charges, as well as potential anticompetitive practices. Justice urges that until and unless the Commission is satisfied that the measures proposed in its own comments (or any others, if necessary) are adequate to deal with the type of competitive problems involved here, the Commission should not entertain any further 211 applications by telephone companies to construct CATV and other wide-spectrum facilities, whether for affiliates or not, as possibly the only solution to encourage the healthy competitive development of the vast potential of broadband coaxial cable. The National Businessmen's Council and the ADA advocate wide-band switched network carrier systems based on common carrier public utility principles, with telephone companies having equal opportunity to provide the total communications service, including CATV, except for the control of content of broadcast matter.

42. Reply comments were filed by eight parties, five of which are telephone companies and USFTA;⁴ the other three are NAEB, Oxnard Cablevision, Inc. (Oxnard), and the City of New York (City).⁵ The City's purpose in filing comments is mainly to support Justice's recommendations that the Commission (1) require telephone companies to offer pole space to all applicants on a nondiscriminatory basis; and (2) prohibit restrictions on CATV systems use of cable, except as necessary to protect the integrity of the network. Oxnard's comments take the form of a complaint of General's refusal to grant

⁴ On Sept. 8, 1969, Radio Hanover filed a petition for leave to file a rejoinder, and a rejoinder to the replies of United and USFTA with respect to the status of Radio Hanover's antitrust litigation against United. The order herein grants the petition, and the rejoinder is made part of the record in this inquiry.

⁵ The City of New York and G.T. & E. replies were not timely. However, in view of the importance of the subject matter of this inquiry, the Commission has accepted the documents and has given them due consideration.

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pole line attachment rights to Oxnard, thus allegedly abusing its local monopoly power in Oxnard (and elsewhere) by literally barring independent CATV operators from entry into the market except on the carrier's own terms, a lease-back arrangement. The telephone companies essentially reiterate and reemphasize their previously expressed position in (a) denying the Commission's legal authority to inquire into telephone company CATV ownership affiliation; (b) insisting that the real problem is not that of common carrier acting as program originators, but rather that of CATV operators acting as common carriers; (c) alleging that CATV operators are generally motivated in their filings more by their own anticompetitive aspirations than by any concern for the public interest; (d) insisting that Justice's proposals for a moratorium in processing section 211 applications to construct wide spectrum systems go far beyond the matters noticed herein for inquiry; would be wasteful; and would prevent the rendition of needed public service to CATV systems as well as to network TV, ETV, videophone, closed circuit TV, and broad band data; (e) declaring that equal and nondiscriminatory access by all CATV applicants to poles and conduits would preclude the possibility of facilities planning; would jeopardize the integrity of communications; and would place the independent CATV's in a monopoly position; (f) arguing that the various present regulatory controls are adequate to prevent any of the alleged abuses; and (g) arguing that most of the complaints set forth against the telephone companies are vague, and others are clearly of antitrust character, thus irrelevant within the framework of this proceeding.

Evaluation and Conclusions

13. Although the preceding paragraphs present only some of the highlights of the comments and reply comments submitted, all documents have been considered in all their pertinent detail in the final evaluation of their effect on our conclusions. The central problem, as it appears to us from these documents, is the anomalous competitive situation between CATV systems affiliated with the telephone companies, and those which have no such affiliation, but have to rely on the telephone companies for either construction and lease of channel facilities or for the use of poles for the construction of their own facilities.⁴

14. The notice attempted to spell out some of the related legal and economic problems which require an early resolution, such as the equitable use of facilities by the independent CATV operators; the prevention of potential favoritism by the telephone company towards its affiliated CATV system, either in the methods of establishing it, or by subsidizing the affiliate to the detriment of its telephone subscribers; and the fending off of any potentially undesirable social and

⁴ The distributive cable network of a CATV system is provided either by channels constructed and leased by common carriers, or by attaching the CATV operator's own cables to utility poles (or using underground conduits) controlled by the telephone companies as direct owners, or through their arrangements with other utilities. The CATV system would normally have to use the same set of poles or conduits as the telephone company, because the communities generally will not permit the construction of duplicate sets of poles or conduits.

economic consequences of concentration of control as a result of direct or indirect operation of CATV systems by telephone companies.

45. The Justice Department and most of the independent CATV parties argue that the telephone companies have been seeking to extend their regulated telephone monopoly into the areas of CATV and broadband coaxial cables, primarily to assure themselves of control over the services broadband coaxial cable will perform in the future. The Justice Department, believing that telephone company-CATV affiliation would inhibit the development of these new services on a competitive basis, proposes to keep telephone companies out of CATV ownership and operations within their telephone service areas, except in cases involving remote communities where "no reasonable alternative operator exists at present or in the foreseeable future." It also recommends that we freeze the granting of all telephone company applications for 211 broadband cable authorizations pending the adoption of adequate regulatory measures. We do not believe that such action is necessary to assure the unhampered growth of the wide-spectrum services. However, we shall be alert to any discriminatory or anticompetitive attempts discussed in the Department's comments. In our opinion, the Department's essential concerns will be met by the actions we are taking herein.

46. The entry by a telephone company, directly or through an affiliate, into the retailing aspects of CATV services in the community within which it furnishes communications services can lead to undesirable consequences. This is because of the monopoly position of the telephone company in the community, as a result of which it has effective control of the pole lines (or conduit space) required for the construction and operation of CATV systems. Hence, the telephone company is in an effective position to preempt the market for this service which, at present, is essentially a monopoly service in most population centers. It can accomplish this by favoring its own or affiliated interest as against nonaffiliated interests in providing access to those pole lines or conduits. Numerous parties have complained that this, in fact, has occurred in many communities where the telephone company has entered into a pole attachment arrangement with its affiliated CATV company to the exclusion of others who may have sought such arrangements on reasonable terms. Accordingly, the actions we are taking herein are designed to prevent, as much as possible, any such abuse.

47. Moreover, telephone company preemption of CATV service in a community not only tends to exclude others from entry into that service, but also tends to extend, without need or justification, the telephone company's monopoly position to broadband cable facilities and the new and different services such facilities are expected to be providing in the future. This is because CATV service represents the initial practical application of broadband cable technology for providing services requiring a wider spectrum distribution facility than can be supplied within the technical capability of the existing plant of the telephone company. In this regard, there is a substantial expectation that broadband cables, in addition to CATV services, will make economically and technically possible a wide variety of new and different services involving the distribution of data, information stor-

age and retrieval, and visual, facsimile and telemetry transmission of all kinds. There is also a real potential that such services will be furnished over regional and national networks consisting of local broadband cable systems interconnected by intercity microwave, coaxial cable and communications satellite systems. Whether these services will evolve in a common carrier mode or some other institutional structure remains for future determination in the light of future developments. However, there is, at present, ample basis for regarding the provision of CATV service within a community as, at least, one important gateway to entering the yet undeveloped market for these other wide-spectrum services. Thus, it is our purpose to insure against any arbitrary blockage of this gateway.

48. It is entirely understandable and appropriate that telephone companies should seek to equip themselves with the facilities required to meet existing and anticipated demands of the public for broadband facilities and services. However, in the process of doing so, we cannot condone their employment of policies which result in denying others the opportunity to also enter the new and emerging markets for facilities and services. We believe that the public interest in modern and efficient means of communications will best be served, at this time, by preserving, to the extent practicable, a competitive environment for the development and use of broadband cable facilities and services and thereby avoid undue and unnecessary concentration of control over communications media either by existing carriers or other entities. We are of the opinion that the preservation of such competition will best be assured by the exclusion of telephone companies in their service areas from engaging in the sale of CATV service to the viewing public except where no practical alternative exists to make such service available within a particular community.

49. In view of the foregoing, it shall be our policy to bar all telephone common carriers from furnishing CATV service to the viewing public in their operating territory except when, for good cause shown, a waiver of this policy is granted. Accordingly, we shall require telephone common carriers, seeking authority under section 214 of the Communications Act to construct and operate distribution facilities for channel service to CATV systems, to make an appropriate showing in their applications that the proposed CATV customer or customers is unrelated to or unaffiliated directly or indirectly with the applicant. Applications which do not contain such showing will be returned as unacceptable for filing. As a concomitant to this policy, and in view of the ability of telephone common carriers to use their monopoly position with respect to pole lines and conduit space to potentially exclude others from entering into CATV service, as discussed above, telephone common carriers will also be precluded from providing CATV service directly or indirectly to the viewing public by entering into pole line or conduit rental agreements with their affiliates in communities where they provide exchange service. (Cf. *Tele-Cable Corp.*, 17 F.C.C. 2d 517, 19 F.C.C. 2d 574, 590; *Manatee Cablevision* 48 F.C.C. 2d 819.) To fulfill the intended purpose of this report and order, we shall broadly interpret the concept of affiliation between

the telephone company and its proposed CATV customer, and our rules shall so provide.

50. In the case of their CATV affiliates, presently operating, we find that to assure a meaningful implementation of the above policies, it is necessary that telephone common carriers be also required to discontinue providing CATV service to the public in their service areas through such indirect method. However, to assure that existing CATV services would not be precipitously withdrawn from the public, temporary authorizations will be granted under section 214 to cover existing common carrier CATV channel services furnished to an affiliate, with the specific condition that these services be discontinued within 4 years from the effective date of this report and order.

51. We conclude that there is no justification for including any specific exceptions from the policy spelled out in paragraph 49. We believe that, where the need exists, there will be nonaffiliated, independent CATV systems ready, willing and able to service any area in which a telephone company would otherwise seek to provide service through an affiliated CATV system. Given the 4-year period for discontinuance of providing CATV service by telephone common carriers or their affiliates, we believe that no substantial segment of the public would be deprived of CATV service. In those rural communities, and communities of low population density where CATV service demonstrably could not exist except through an affiliate of the local telephone company and thus a telephone affiliate may be the only feasible source of CATV service to a community, adequate provisions will be made for waivers of any of our rules in such cases (with the understanding that appropriate accounting safeguards will be employed, as to the regulated, versus unregulated, operations of the affiliated telephone company).

52. We do not believe that our change in policy will have any effect upon the recognized role of local or State government agencies in their choice of who should be licensed or franchised to be CATV operators. Both the State and/or municipal agencies will continue to be free to franchise any nonaffiliated independent CATV system where such franchising is now part of the local law, while any tendency or opportunity for discrimination by a telephone company on behalf of an affiliated CATV system will be removed.

53. It appears from the record in this proceeding, as well as from the various other information heretofore formally brought to our attention, that the potential seedbed of the controversy has been the independent CATV systems' alleged difficulty in obtaining pole line attachment agreements from the local telephone companies. Since pole lines are an essential part of the problem, they must necessarily be also part of the solution. Consequently, it is our further conclusion that any future authority to a telephone company under section 214(a) of the act to provide CATV channel facilities, should be conditioned upon a documented showing that the customer CATV system had available, at its option, pole attachment rights (or conduit space, as the case may be) (a) at reasonable charges, and (b) without undue restrictions on the uses that may be made of the channel by the customer. This option must be open to the CATV customer not only at the time

of the grant but also prior to its decision to seek an award of a local franchise. Additional showing is also required that this policy was made known to the local franchising authority.⁷

51f. Pole line attachment (or conduit) rights must be offered on a nondiscriminatory basis where space for such facilities can reasonably be made available without impediment to the telephone company's obligation to supply non CATV communications services to the public. The existence of technical limitations, which might prevent the leasing of space for additional lines on existing poles, should be convincingly shown by the telephone company and the exception be limited to the duration of the technical problem.

55. The principal assertion of some of the commenting telephone companies is, in effect, a challenge to the Commission's jurisdiction to conduct this inquiry and rulemaking proceeding. Specifically, United questions every one of the provisions listed in the notice as the statutory basis for the inquiry (secs. 2, 3, 4 (i) and (j), 214, 301, 303, and 493 of the Communications Act). In reply, it is sufficient to point out that section 2(a) makes the provisions of the act applicable "to all interstate and foreign communication by wire or radio * * *" section 3 (a) and (b) states that communication by wire or radio includes "all instrumentalities, facilities, apparatus and services (among other things, the receipt, forwarding and delivery of communications) incidental to such transmission." Section 301 specifies that the purpose of the act is "to maintain the control of the United States over all the channels of interstate and foreign radio transmission; * * *". And the courts have recognized that the act confers comprehensive regulatory power on the Commission: *United States v. Southwestern Cable Co.*, 392 U.S. 157 (1968); *National Broadcasting Co. v. United States*, 319 U.S. 190, 219 (1943); *Federal Communications Commission v. Pottsville Broadcasting Co.*, 309 U.S. 134, 138 (1940). As for section 214, "The standard of 'public convenience and necessity' is to be so construed as to secure for the public the broad aims of the Communications Act." *Western Union Division v. United States*, 87 F. Supp. 324, 335 (USDC, D. of C. 1949), affirmed in 338 U.S. 864. The most recent case, confirming the Commission's authority with respect to section 214 certification requirement of telephone companies in CATV channel service application proceedings, is *General Telephone Company of California v. F.C.C.*, 413 F. 2d 390, decided April 30, 1969, by the U.S. Court of Appeals for the District of Columbia Circuit (certiorari denied by the Supreme Court on Oct. 27, 1969, No. 357).

56. The telephone industry's comments and replies also specifically question the Commission's legal authority to limit the scope of telephone company ownership affiliation with CATV systems. Their position appears to be based on the argument that the nature of CATV ownership is as varied as that of any American enterprise; that CATV systems are known to be owned by other communications media; and that, therefore, the singling out of telephone companies for special

⁷ American Telephone & Telegraph Co. & General Telephone & Electronics Corp., on Oct. 27, 1969 and Dec. 1, 1969, respectively, advised the Commission of their present policy with respect to the conditions under which they are ready to enter into pole line (or underground conduit space) agreements with CATV systems. The communications are herewith annexed as Appendix B.

treatment in this respect is making them second-class citizens. We are unable to agree with the telephone industry's complaint, either legally or factually. We have proposed rules in docket No. 18397 which would preclude cross-ownership of CATV and local broadcast media. Moreover, the prevention of undesirable concentration of control of communications media has always been of great concern to us. There surely cannot be any question about our authority to regulate the telephone companies' interstate communications activities, and, by now, our authority to issue regulations pertaining to CATV operations is equally well established.⁸ Similar restrictions on concentration of ownership in the public interest have been held fully within the Commission's statutory mandate. In *U.S. v. Storer Broadcasting Co.*, 351 U.S. 192, the Court, inter alia, held that the Commission's power to issue regulations authorizes it to limit concentration of stations under a single control. Since the standard of public convenience and necessity is the watchword of any section 214 grant, there should be no question about our responsibility to make it certain that any authorization issued by us will not be used as a tool of discrimination and unfair competition, and will not inhibit the future growth and development of the wide-spectrum services. On the contrary, our authorizations should assure that the common carrier applicant's service is offered in a manner consistent with the best interest of the community it serves.

57. It is also urged by some of the telephone companies that the complaints alleging anticompetitive and discriminatory practices on the part of the telephone companies are primarily antitrust issues and do not come within our basic jurisdiction. It is urged that any action taken by us to promulgate rules pertaining to such matters would be an attempt to enforce the antitrust laws of the United States which function Congress has delegated to the Department of Justice. This contention has been advanced before, and is expressly rejected by the courts. *Mansfield Journal Co. v. F.C.C.*, 180 F. 2d 28; *N.B.C. v. U.S.*, 319 U.S. 190. It is not open to question that antitrust policies and the public interest standard of the Communications Act are closely related, and that we are obliged to give weight to that policy in applying the statutory standard. *U.S. v. R.C.L.*, 358 U.S. 331, (1959) where the Court noted that:

• • • This Court consistently held that when rates and practices relating thereto were challenged under the antitrust laws, the agencies had primary jurisdiction to consider the reasonableness of such rates and practices in the light of the many relevant factors including alleged antitrust violations, for otherwise sporadic action by federal courts would disrupt an agency's delicate regulatory scheme, and would throw existing rate structures out of balance.

58. It has been repeatedly argued in the replies of the telephone companies that many of the comments, critical of the CATV-telephone company affiliation, were not supported with specific facts and detailed descriptions of anticompetitive practices. However, telephone company participants fail to consider that the subject proceeding is a general inquiry, not directed to specific complaints. We invited interested parties to comment on the general problems posed by the effects

⁸ *U.S. v. Southwestern Cable Co.*, 392 U.S. 157 (1968).

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of potentially inherent anticompetitive conditions of telephone company-CATV affiliations and of the possible adverse consequences thereof to the public interest. We are satisfied that the prevention of such possible abuses fully warrant our policy findings herein, and the new rules which will implement them.

59. United in its reply⁹ also objects to the consideration of pole attachment agreements in this inquiry, for the reason that these matters could be properly considered only in the consolidated tariff proceedings.¹⁰ However, in paragraph 7 of the notice, referring to "alleged anticompetitive activities of the telephone companies in connection with both pole line attachment practices and tariffs," we wished to make clear that although these practices are in issue in the consolidated tariff case, they may be pertinent to this inquiry as well. Accordingly, we invited comments insofar as those practices may have a bearing on the questions to be resolved in this proceeding.

60. One of the applications (Heins Telephone Co., File No. P-C-7188), included among the 17 listed in the appendix to the notice of inquiry, allegedly involves a little over 10 percent stock ownership on the part of one of the applicant telephone company's officers in the CATV system. It has been urged that the limited extent of the relationship should exclude such application from the scope of this proceeding. We believe, however, that the goal of barring any undesirable concentration of control of communications media and the realities of the situation require that no distinction be made between a minority noncontrolling interest and a full or controlling one, except in large, publicly held corporation with more than 50 stockholders. While the holder of a small interest in many instances may have a slight influence on the operation of the CATV system in question, it is also true that such a person through his various affiliations, etc., may exert a considerable influence -- potentially defeating the policies enunciated in this report and order.

61. Several questions in the notice inquire into the adverse financial or technical effects of CATV-telephone company ownership affiliation on the telephone company's furnishing of service to its telephone subscribers. However, the comments (and the replies to them) do not provide sufficient informational basis for any specific findings in this regard. Furthermore, in view of our conclusions restricting telephone company CATV affiliations in the service areas of the telephone companies, the cause for concern over potential discriminatory practices will be considerably decreased. The situation is similar with respect to the possible danger of subsidization of affiliated CATV operations by telephone company, making specific findings unnecessary at this time. However, should future developments require it, such matters may be the subject of a later proceeding.

62. Various comments were addressed to the regulatory ramifications of the future uses of broad band channels. At this point it is impossible to foresee, let alone to provide for, the needed policy or regulatory guidance as to those matters. However, we expect to give

⁹ Page 9, par. 11.

¹⁰ CATV Channel Service Tariff proceedings in dockets Nos. 16929, 16943, and 17098 of P.C.C. 2d 175, 433, 434, 440, 441).

continued consideration to all new wide-spectrum service offerings, and will continue to encourage full and free competition in the development of such services under appropriate tariffs by all interested parties.⁴¹

63. In light of all of the foregoing, and to implement our above findings we conclude that the public interest would be served by the adoption of the rules set forth in appendix A. Authority for the rules adopted is contained in sections 2, 3, 4 (i) and (j), 214, 301; 303, 307, 308, 309, and 403 of the Communications Act.

64. Accordingly, *It is ordered*, That the rules set forth in appendix A hereto *Are adopted*, effective March 16, 1970, and that this proceeding is hereby *Terminated*.

FEDERAL COMMUNICATIONS COMMISSION,
BEN F. WAPLE, *Secretary*.

APPENDIX A

1. Part 63 is amended as follows:

New sections 63.51, 63.55, 63.56, and 63.57 are added to read as follows:

§ 63.51 *Applications of telephone common carriers for construction and/or operation of CATV channel facilities in their service areas.* Applications by telephone common carriers for authority to construct or operate distribution facilities for channel service to community antenna television (CATV) systems in their service areas shall include a showing that applicant is unrelated and unaffiliated, directly or indirectly, with the proposed CATV customer or customers. Applications which do not contain the showing required by this section will be returned as unacceptable for filing.

Note 1: (a) As used in the above paragraph, the term "unrelated and unaffiliated" bars any financial or business relationship whatsoever by contract or otherwise, directly or indirectly, between the carrier and the customer, except only the carrier-user relationship.

(b) Examples of situations in which a carrier and its customer will be deemed to be related or affiliated include the following among others: where one is the debtor or creditor of the other (except with respect to charges for communication service); where they have a common officer, director, or other employees at the management level; where there is any element of ownership or other financial interest by one in the other; and where any party has a financial interest in both.

Note 2: In applying the provisions of the above paragraphs of this section to the stockholders of a corporation which has more than 50 stockholders:

(a) Only those stockholders need be considered who are officers or directors or who directly or indirectly own 1 percent or more of the outstanding voting stock;

(b) Stock ownership by an investment company, as defined in 15 U.S.C. section 80a-3 (commonly called a mutual fund), need be considered only if it directly or indirectly owns 3 percent or more of the outstanding voting stock or if officers or directors of the corporation are representatives of the investment company. Holdings by investment companies under common management shall be aggregated. If an investment company directly or indirectly owns voting stock in an intermediate company which in turn directly or indirectly owns 50 percent or more of the voting stock of the corporation, the investment company shall be considered to own the same percentage of outstanding shares of such corporation as it owns of the intermediate company: *Provided, however*, That the holding of the investment company need not be considered where the intermediate company owns less than 50 percent of the voting stock, but officers or directors of the

⁴¹ On Jan. 11, 1967, in docket No. 17098, F.C.C. 67-59 we instituted an investigation into the lawfulness of the CATV channel service tariffs of the General Telephone and the United Utilities Systems which tariffs among others contain provisions restricting the use of their wide spectrum channel offerings to CATV service only.

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corporation who are representatives of the intermediate company shall be deemed to be representatives of the investment company).

(c) In cases where record and beneficial ownership of voting stock is not identical (e.g., bank nominees holding stock as record owners for the benefit of mutual funds, brokerage houses holding stock in street name for the benefit of customers, trusts holding stock as record owners for the benefit of designated parties), the party having the right to determine how the stock will be voted will be considered to own it for the purposes of this section.

§ 6355 *Waivers.* In those communities where CATV service demonstrably could not exist except through a CATV system related to or affiliated with the local telephone common carrier, provisions in § 6354 may be waived.

§ 6356 *Temporary authorizations under Section 214(a) during period allowed for discontinuance of CATV service by telephone common carriers directly or through affiliates.* All telephone common carriers are required to discontinue providing CATV service directly or through their existing affiliated or related CATV systems within four years from March 16, 1970; *Provided, however,* That during the said four year period temporary authorizations may be granted under Section 214(n) of the Act, to cover existing telephone common carrier CATV channel services furnished to an affiliated or related CATV system.

§ 6357 *Availability of pole (conduit) rights to CATV customer.* Applications by telephone common carriers for authority to construct or operate distribution facilities for channel service to CATV systems shall include a showing (in addition to the conditions set forth in the above sections) that the independent CATV system proposed to be served, had available, at its option, and within the limitations of technical feasibility, pole attachment rights (or conduit space, as the case may be), at reasonable charges and without undue restrictions on the uses that may be made of the channel by the customer. This availability must exist not only at the time of the authorization but also prior to the customer's decision to seek an award of a local franchise, if such is required, and that such policy of the applicant is made known to the local franchising authority. Separate documents, attesting the above conditions, by the CATV customer and, where applicable, by the appropriate local franchising authority, must be annexed to the application.

11. Part 61 is amended by adding a new Subpart F, and Sections 61601 and 61602 to read as follows:

Subpart F—Pole Attachments and Other Arrangements Relative to CATV Service.

§ 61601 *Furnishing of Facilities for CATV Service to the Viewing Public.*

(a) No telephone communications common carrier subject in whole or in part to the Communications Act of 1934, as amended, shall directly or indirectly through an affiliate owned or controlled by or under common control with said telephone communications common carrier, engage in the furnishing of CATV service to the viewing public in its telephone service area.

(b) No telephone common carrier subject in whole or in part to the Communications Act of 1934, as amended, shall provide channels of communications or pole line, conduit, space or other rental arrangements to any entity which is directly or indirectly owned, operated or controlled by such telephone communications common carrier, where such facilities or arrangements are to be used for or in connection with the provision of CATV service to the viewing public in the service area of the said telephone common carrier.

NOTE 1: (a) As used above, the terms "control" and "affiliation" bar any financial or business relationship whatsoever by contract or otherwise, directly or indirectly, between the carrier and the customer, except only the carrier-user relationship.

(b) Examples of situations in which a carrier and its customer will be deemed to be controlled or having an interest, include the following, among others: where one is the debtor or creditor of the other (except with respect to charges for communication service); where they have a common officer, director, or other employees at the management level; where there is any element of ownership or other financial interest by one in the other; and where any party has a financial interest in both.

Note 2: In applying the provisions of paragraph (a) of this section to the stockholders of a corporation which has more than 50 stockholders:

(a) Only those stockholders need be considered who are officers or directors or who directly or indirectly own 1 percent or more of the outstanding voting stock;

(b) Stock ownership by an investment company, as defined in 15 U.S.C. section 80a-3 (commonly called a mutual fund), need be considered only if it directly or indirectly owns 3 percent or more of the outstanding voting stock or if officers or directors of the corporation are representatives of the investment company. Holdings by investment companies under common management shall be aggregated. If an investment company directly or indirectly owns voting stock in an intermediate company which in turn directly or indirectly owns 50 percent or more of the voting stock of the corporation, the investment company shall be considered to own the same percentage of outstanding shares of such corporation as it owns of the intermediate company; *Provided, however*, That the holding of the investment company need not be considered where the intermediate company owns less than 50 percent of the voting stock, but officers or directors of the corporation who are representatives of the intermediate company shall be deemed to be representatives of the investment company.

(c) In cases where record and beneficial ownership of voting stock is not identical (e.g., bank nominees holding stock as record owners for the benefit of mutual funds, brokerage houses holding stock in street name for the benefit of customers, trusts holding stock as record owners for the benefit of designated parties), the party having the right to determine how the stock will be voted will be considered to own it for the purposes of this section.

§ 61.602 *Waivers.* In those communities where CATV service demonstrably could not exist except through a CATV system related to or affiliated with the local telephone common carrier, provisions in § 61.601 may be waived.

APPENDIX B

AMERICAN TELEPHONE & TELEGRAPH COMPANY,

195 Broadway, New York, N.Y. 10007,

October 27, 1969.

The Honorable ROSEL H. HYDE,

Chairman, Federal Communications Commission,
1919 M Street NW., Washington, D.C. 20554.

DEAR CHAIRMAN HYDE: The Bell System operating companies have recently reviewed certain questions pertaining to the provision of facilities or services to cable television operators. While the companies believe that their policies and practices in this area have been reasonable, evolving circumstances have indicated that certain modifications may be appropriate. Some general conclusions have been reached and will require detailed implementation; however, it seems appropriate to advise you now of these conclusions. They are:

1. The companies will make all reasonable efforts to provide pole attachments to all legally qualified applicants at appropriate charges;
2. The companies will develop procedures under which access may be provided in their underground conduits and ducts, under controlled conditions and where reasonably available, to legally qualified entities at appropriate charges;
3. The companies will modify both their tariffs for CATV channel services and agreements for pole attachments to make it clear that they may be used for any lawful transmissions.

The companies are proceeding expeditiously with specific practices to implement these changes. I would be happy to discuss this matter further as you wish.

Very truly yours,

D. E. EMERSON.

GENERAL TELEPHONE & ELECTRONICS CORPORATION,

730 Third Avenue, New York, N.Y. 10017,

December 1, 1969.

The Honorable DEAN BURCH,

Chairman, Federal Communications Commission,
1919 M Street NW., Washington, D.C. 20554.

DEAR CHAIRMAN BURCH: The General System Operating Companies have

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adopted a new policy with respect to the provision of facilities and services to cable television operators. A copy of this new policy is attached.

This policy was adopted to assure that the same opportunities will be afforded to *all* members of the cable television industry in General Telephone operating territory whether the CATV operator elects pole attachments or telephone company channel services. We believe that adoption and implementation of this policy will eliminate the differences which have existed in the past between some members of the CATV industry and the General System and permit us all to move forward on a constructive basis.

Should you have any questions concerning this matter, we would be happy to meet with you or your staff to discuss any aspects of the policy.

Very truly yours,

THEODORE F. BEERY,

TFB:zo

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cc: COMMISSIONER BARTLEY

COMMISSIONER COX

COMMISSIONER JOHNSON

COMMISSIONER H. BEN LEE

COMMISSIONER E. E. LEE

COMMISSIONER WELLS

HENRY GELLER, *General Counsel*

SOL SCHULDBACH, *Chief, CATV Task Force*

BERNARD STRASSBURG, *Chief, Common Carrier Bureau*

December 1, 1969.

General System Policy Re Pole Attachments
and Services for CATV Industry

I. Pole Attachments

(a) Rights will be granted to any duly franchised applicant for the attachment of CATV facilities to telephone company poles upon execution of an appropriate pole attachment agreement.

(b) There will be no contractual restriction on the use of excess capacity in bona fide CATV facilities so long as such excess capacity is used for a lawful purpose.

II. Cable Ducts

(a) Customer-owned CATV facilities may be connected to CATV channel service provided by the telephone company through telephone company facilities located in cable ducts, or

(b) telephone companies will install and maintain customer-owned CATV facilities in telephone company ducts, subject to availability of space.

(c) Such connection or installation and maintenance will be provided under applicable tariffs or appropriate agreement.

III. Removal of CATV Facilities

(a) Any customer-owned CATV facilities attached to a telephone company pole or installed in a telephone company duct must be removed at the CATV operator's expense upon the loss by the CATV operator of its franchise or if the facilities at any time cease to be used as bona fide CATV facilities.

IV. Telephone Company Channel Service

(a) Telephone companies will seek to amend their FCC channel service tariffs to offer special channel service for CATV to any franchised CATV operator but not for CATV use by a nonfranchised CATV operator except in a case where no franchising authority exists.

(b) Under proposed amended FCC tariffs the CATV operator will be permitted to use the channel service for CATV and the excess capacity for any lawful purpose.

V. Telephone Company CATV Affiliates

(a) A telephone company will not provide channel service or pole attachments to the telephone company's CATV affiliate in any area in the telephone company's operating territory if such facilities would duplicate existing CATV facilities.

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[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question 1. Do the states have a legitimate interest in cable activities because of the use of public rights-of-way?

Answer. We would agree that because cable television systems typically utilize public rights-of-way, local governmental authorities do have a legitimate interest in oversight of any cable activities which are reasonably related to such use, which usually focuses upon the award and supervision of franchises. This process is usually best accomplished at the municipal or local level, and an additional tier of state regulation usually only compounds administrative burden with no attendant benefits to the public. As S. 622 correctly recognizes, there are certain matters of such overriding Federal concern, such as carriage of television broadcast signals, that nonfederal regulation must be precluded.

Question 2. Does the Federal Government have a legitimate interest in the carriage of distant broadcast signals, which affects the broadcaster, who is regulated under a public interest standard by the FCC?

Answer. As the Supreme Court recognized in *Southwestern Cable Co. v. U.S.*, 392 U.S. 157 (1968), the carriage of distant broadcast signals is "interstate commerce" even when the signals originate in the same state as the cable system. S. 622 is clearly correct in precluding non-federal regulation of broadcast signal carriage.

However, the fact that the federal rather than state governmental level has the legitimate interest in the carriage of distant broadcast signals does not resolve the issue of whether regulation of such signal carriage should be imposed at the federal level.

It has become clear to the FCC that it would be the rare case where a cable system's carriage of distant broadcast signals would have any detrimental effect on the ability of the local broadcaster to serve the public interest. In response to this judgment the agency has issued a *Notice of Propose Rulemaking* in Docket Nos. 21284 and 20988 to remove the current distant signal regulations of cable systems.

The proposed rules would eliminate the burden of proof on cable systems to demonstrate that signal carriage would not harm local broadcasters. Rather, because of the evidence that cable systems do not generally impact broadcasting, the burden to move the need for artificial protection against signal carriage would be placed on the local broadcaster.

Therefore, we believe that the approach taken by section 335(f)(2) of S. 622 is wrong in two respects. First, it mandates the FCC to impose broad general signal regulations on cable. Secondly, the burden of proof to eliminate the application of such signal restrictions would be imposed on cable systems on a case-by-case basis. Any exercise of federal jurisdiction over this matter should only be on a case-by-case basis upon a substantial showing by the local broadcaster that without such protection his ability to serve the public will be appreciably affected. S. 611 appears to adopt this latter approach in large part in a fashion consistent with the overall deregulatory marketplace approach otherwise evident in S. 622.

Question 3. If a cable system is the sole source of video programming, and thus a monopoly, should access by parties not affiliated with the cable system be required?

Answer. If the cable operator were a monopoly in this latter sense, we would agree that a reasonable portion of unused channel capacity should be made available for access at reasonable rates. We are pleased that S. 622 takes such a moderate approach to this problem¹ although because the cable industry is currently providing access to the public voluntarily, and remains committed to that goal, we believe access regulations applicable to the cable industry generally should not now be mandated by either the Federal or State level.

Question 4. How important is it that states be precluded from rate regulation?

¹In this connection we assume that S. 622 means what it says—that cable systems must be the sole source of video programming, not merely the sole source of cable programming. The difference is crucial, of course, because the cable system, although it generally does not compete with co-located cable systems, faces substantial competition from a myriad of other program sources such as broadcast television, MDS, STV, video discs and theaters. Saddling cable systems with common carrier regulation despite this competition would be disastrous.

We also feel we should point out that S. 622 apparently contemplates that the FCC leased access rules could require that existing services be displaced in favor of later prospective lessees. We think that this is not desirable and that if all channel space is already filled, the prospective lessee should be required to pay for expanding the system. This is consistent with the approach taken by the FCC's leased access rules when they were still in force.

Answer. As we understand it, the thrust of S. 622, as well as similar pending rewrite efforts and FCC actions, is to permit the marketplace to operate free from governmental intervention whenever possible. As indicated above, cable television systems, which provide a non-utility luxury entertainment service, are subject to a constantly increasing level of effective competition. If we set our rates too high, we will lose subscribers. Thus, the marketplace is the best regulator of our rates. In order to compete with the above-described non-regulated services, cable rate regulation must be precluded at all levels, except perhaps where there is inadequate over-the-air broadcast service available (i.e., less than three network signals).

Question 5. If the telephone companies are allowed to offer some broadband services, how should Congress appropriately draw the line in what they are permitted to offer and precluded from offering?

Answer. Teleprompter supports the cable industry-telephone industry compromise proposal of which you are aware.

Question 6. S. 622 precludes them from providing entertainment and news programming. How would you define these terms?

Answer. See answer to question 5 above.

Question 7. Is it important to identify cable television as an integral part of our national communications systems?

Answer. Unquestionably cable performs a vital function in the stream of interstate communications. As we have indicated, the Courts have consistently found cable carriage of broadcast signals to be interstate commerce. Moreover, the proliferation of nationwide distribution of new and innovative programming services delivered via the interconnected satellite network vividly emphasizes the interstate nature of the cable television industry. It is essential that Congress recognize that cable is an integral part of our national communications system, not ancillary or secondary to any other medium of telecommunications.

Question 8. Should legislation clearly delineate federal and state jurisdiction?

Answer. One of the most significant controversies surrounding the FCC's cable television regulatory program has been the appropriate distribution of jurisdiction between the Federal and State/local levels. See, *Cable Television Report and Order*, 36 FCC 2d 143 (1972) at paras. 171-188, *Report and Order re Duplicative and Excessive Over-Regulation of Cable Television*, 54 FCC 2d 855 (1975). Congress would be performing a great service by clearly delineating jurisdictional boundaries, which is the approach taken by S. 622. As we have indicated, we would give the FCC discretion to preempt those additional areas which are so imbued with the federal interest in the free flow of interstate communications as to be precluded from regulation at any level, thus promoting the free functioning of the marketplace.

Question 9. Should the FCC be concerned with technical standards for cable system operations?

Answer. The current FCC cable television technical standards are more than adequate to assure quality service to consumers and to protect against interference to other telecommunications services. Yet many well-meaning state or local authorities attempt to impose different technical and performance standards, usually due to lack of familiarity with cable technology. If cable television is to continue to develop as a national telecommunications medium, it is essential that cable systems be built and CATV electronic components be designed in conformity with uniform national standards. Just as S.622 recognizes in Section 225(b)(9) that telephone terminal equipment must be governed by uniform technical standards to assure interconnectability, so must uniform federal technical standards apply to cable television to avoid a patchwork of non-compatible regulation.

Question 10. Should the Federal Government ensure the privacy of cable subscribers?

Answer. While we are unaware of any current alleged invasions of the privacy of cable subscribers, we are not opposed to Section 335(k) of S.622.

Question 11. Should the states be precluded from requiring or prohibiting program origination?

Answer. As we have demonstrated, cable television program content flows in the stream of interstate commerce and has no nexus to the reasonable use of streets and rights-of-way. A significant number of municipalities have attempted to prohibit cable television program origination, usually in response to pressure from local broadcasters or theatre owners. Such a result would impede interstate commerce and would be contrary to the fundamental purpose of the FCC: to enhance telecommunications diversity. Conversely, as the Commission concluded in withdrawing its former mandatory origination rules, regulatory fiat cannot create programming. Subsequently, marketplace forces have resulted in an explosion of innovative program diversity by the cable industry. Thus, S.622 has correctly precluded any Federal, state, or local authority from requiring or prohibiting program origination.

Question 12. Should broadcasters, broadcast networks, and publishing companies be precluded from owning or controlling a cable system or systems?

Answer. Broadcasters should not be precluded from owning or controlling cable systems outside their areas of operations. Broadcast networks should not be allowed to own cable systems because of an obvious conflict of interest. Other cross-ownership restrictions should be imposed only after evidence of specific abuse, which is the case with regard to the cable/telephone cross-ownership ban.

Question 13. Will a guarantee of access to pole by cable operators be sufficient to protect cable operators from unreasonable and discriminatory denial of access?

Answer. The 1978 pole attachment legislation, while going far to assure just and reasonable pole attachment rates, does not guarantee access to the poles in the first instance. Thus, the utilities can preclude competition and frustrate the flow of interstate communications by simply denying access to these essential poles. Indeed, when informed by cable operators that they were seeking relief under the just and reasonable rate provisions of the pole law, many utilities have responded by canceling the contracts and ordering cable off the poles.

A mere guarantee of access, however, would not totally insure against unreasonable and discriminatory practices. As the case studies attached to my testimony indicate, telephone companies, even after agreeing to provide access, have a host of methods for frustrating competition. For example, they can require surveys, changeouts, make ready and other dilatory practices which allow their own subsidiary or preferred channel lessee to complete construction prior to the independent cable operator and thus obtain a crucial competitive advantage. Congress must direct the Commission to provide an expeditious remedy for all discriminatory practices and conditions.

Question 14. Would such a provision prevent discriminatory charges?

Answer. Again, the mere assurance of access will not prevent discriminatory charges. Moreover, a provision that rates be "nondiscriminatory" would be meaningless. As indicated in my testimony, if the telephone company is allowed to enter the cable business through a separate subsidiary, it could set pole attachment rates which are "nondiscriminatory" and yet so high as to preclude entry by unaffiliated entities. The telephone subsidiary could afford such rates because it would not have to make a profit—rather the profit would be derived at the telephone company level. Similarly, if utilities construct broadband plant for lease to unaffiliated parties, lease-back rates could be set low and "nondiscriminatory" pole rates could be set high, again effectively precluding independent ownership and operation of cable systems. Finally, even if rates were truly nondiscriminatory, they might still be highly unreasonable—as was the case before the passage of the recent pole attachment legislation. Therefore we urge that S.622 retain on a permanent basis the formula contained in such legislation.

Question 15. Are there any other ways to prevent abuse by telephone and other utility companies?

Answer. It has been suggested that requiring telephone companies to establish a separate subsidiary would provide adequate safeguards to their entry into the cable television business. We are convinced that simple corporate reorganization would not insure against abuse.

First of all, it must be recognized that "separate subsidiaries" run the full gamut from a meaningless corporate shell to a fully separated entity as contemplated by the FCC's recent decision in the GTE-Telenet merger case. In any event, we seriously doubt whether any separate subsidiary arrangement would be sufficient to insulate against abuse.

The blatant record of anti-competitive conduct compiled by the independent telephone companies in the 1960's was accomplished largely through their separate subsidiaries. Accordingly telephone companies were precluded by the FCC from offering cable television service within their service areas either directly or through a separate subsidiary.

Similarly, the Justice Department obviously believes that the establishment of a separate subsidiary is insufficient to avoid anticompetitive behavior. The 1956 Justice Department Consent Decree precludes AT&T or any separate subsidiary from offering non-common carrier services such as cable television. And in comments to the FCC's Computer Inquiry, the Justice stated as follows:

"We do not believe the record shows that regulatory bodies have been markedly successful in regulating or controlling the cross-dealings between AT&T and its present 'unregulated, separate subsidiaries,' such as Western Electric." *Initial Comments of the United States Department of Justice in Docket No. 20828* (May 26, 1977).

Another suggested procedure is the establishment of uniform accounting procedures. We assume that this would be an essential element of any separate subsidiary requirement.

The magnitude of the task of establishing accounting procedures for the monopoly carrier must not be overlooked. For example, it took the FCC, the expert agency in this field, over 15 years to develop a fully-distributed cost methodology for AT&T's private line services. See, *AT&T Co. (TELPAC)*, 61 FCC 2d 587 (1976). This new procedure still requires a complex cost-justification analysis for each of AT&T's major service categories. Additionally, on June 28, 1978, the Commission commenced the first major overhaul of telephone company accounting practices since 1935. It is still unclear whether these procedures will be effective in identifying cross-subsidies.

It has also been suggested that the cable industry could seek relief from anti-competitive conduct through the vehicle of anti-trust litigation. Antitrust proceedings are simply too costly and time consuming to be an effective remedy. Indeed, President Carter has set up a 21-member blue-ribbon panel in an effort to speed up the antitrust process, noting that "... complex antitrust cases ... frequently drag on for years ..."

In this regard, John Shenenfield, Assistant Attorney General, Anti-trust Division of the Department of Justice, has pointed out the deficiencies of litigation against companies such as AT&T. He stated:

"Thus, you see AT&T today acting as a rational defendant in a Section 2 case—resisting expedition, multiplying issues and obstacles, and engaging in a widespread public relations campaign to portray 'The System' as a victim of quixotic prosecutors and as the saviors of everything from the national defense to pro football telecasts.

"Just two weeks ago, for example, the Chairman of AT&T told a Washington Star reporter that they were assembling a staff of 3,000 people just to handle government discovery requests, and that they thought the suit might cost as much as \$1 billion in legal fees and expenses.

"As for our enormous resources, you have heard me describe them and they are a matter of public record. Mr. deButts and I might file simultaneous affidavits with the court specifying exactly what resources each has committed to the case. Compared to the 'staff of three thousand' that he described to the Star reporter, I am afraid we would feel—in Congressman Celler's old phrase—like 'chickens trying to dance in the ring with elephants.'"

From the foregoing, perhaps you can understand why the cable television industry agrees with the FCC and the Department of Justice that the only effective way to avoid anticompetitive abuse is a total prohibition on telephone company provision of cable television service within their telephone service areas.

Question 16. Should telephone cooperatives and federal entities, such as TVA, be subjected to the pole attachment statute?

Answer. The current federal pole attachment law exempts cooperative and municipally owned utility companies from the federal pole attachment standards. This exemption was included in the current law under the presumption that these utilities would be much less inclined to abuse their monopoly control over poles. Unfortunately, this view has not proven correct.

One example should suffice to emphasize the need to remove the exemption. In seven southern states, numerous cooperative and municipally owned power companies, as members of the Tennessee Valley Public Power Association (TVPPA), have recently received a recommendation from the TVPPA to raise their rates to \$7.00 per pole.

This \$7.00 rate had been agreed to by the South Central Bell for telephone company attachments, and the TVPPA has simply adopted AT&T's rate. Thus, the private telephone company, in effect, set pole rates for cable systems. Individual members of the TVPPA have told cable operators to pay the requested rate or stop attaching to new poles. The TVPPA has rejected any discussion with the state cable associations and has refused to apply any of the federal standards to their members' rates.

It is imperative that the exemption of both cooperative and municipally owned utilities be removed in the new legislation. Removing only cooperatively-owned utilities as proposed in S. 622 is helpful but this does not recognize that the great majority of exempt utilities are municipally owned.

Senator GOLDWATER. All right. The next witness is Mr. Arlow.

STATEMENT OF ALLAN J. ARLOW, VICE PRESIDENT, CENTRAL TELEPHONE & UTILITIES CORP.

Mr. ARLOW. Mr. Chairman, members of the committee:

My name is Allan Arlow and I am a vice president of Central Telephone & Utilities Corp., or Centel, as we are more commonly known. Centel is the fifth largest telephone company in the United States. In addition to providing service to more than a million customers in 11 States, we own and operate electric utilities in Kansas and Colorado and, through a subsidiary, Centel Communications Co., provide cable television service to over 12,000 subscribers in suburban Chicago's Fox River Valley. We have made and are now pursuing additional acquisitions in the CATV market, and this brings me to the underlying purpose for our participation in today's session on S. 611 and S. 622.

Centel speaks from the unique position of being an owner and operator of telephone and CATV systems in different territories. Centel seeks growth and a satisfactory return on investment in both of these business areas to the detriment of neither. Its recommendations with respect to broadband services will, we hope and believe, be beneficial to both industries and to the public.

I would just like to add at this point that Centel management will also be testifying later in these hearings on many aspects of both bills and submitting detailed written testimony as well. For that reason, my prepared comments will be limited to the discussion of the type of legislative framework we feel is needed in S. 611 and S. 622, in the broadband area, keeping in mind that we believe legislation should provide for an environment that will permit and encourage the maximum exploitation of broadband technology in the public interest.

Centel has already begun replacing some of its copper cable with smaller and lighter optical fiber transmission lines. While these transmission lines will make it possible to add substantially greater voice grade capacity without increasing the amount of space needed for the cables, fiber optics also opens up numerous possibilities for the improvement and upgrading of home and business communications services in the years ahead. It would be wasteful to invest in the development and installation of such a system if the opportunity to provide the services of the future should be precluded or limited.

Centel's position both for its CATV systems and telephone systems is, therefore, a fairly simple one: If a party is willing to invest in the development and installation of equipment and supporting technology, that party should be permitted to utilize all technology and offer without restriction all services in a manner which would respond to the public needs as determined by the marketplace and which, by public policy, have not been determined to be a regulated monopoly. Whatever minimal regulation is necessary should be local in nature to respond to particular circumstances.

Our views are reflected in the language of neither bill as they now stand. S. 611 and S. 622 both have the net effect of extending the telephone-CATV cross-ownership ban beyond the current service area limitation to telephone operating companies in general. In the past, cross-ownership rules impeded the telephone companies and lack of capital and regulatory uncertainty impeded CATV systems from developing and providing innovative broadband type services to the public.

Although the bills intent is procompetitive, S. 611 sections 203, 204, and 227, particularly seem to perpetuate these regulatory barriers. Not only would the introduction of new technology be slowed, but the net effect of the enactment of these sections would appear to be truly anticompetitive.

Although other cable companies may fear being steamrollered by telephone company competition, Centel submits that their fears are not justified. With the exception of the Bell System, which we have already discussed this afternoon, industry resources are not unevenly matched; for GTE, United, Continental, and Centel in the telephone camp, there are also Warner, Time, TelePrompTer and Cox on the cable side.

Smaller cable systems and telephone cooperatives are also numerous, and, of course, there may be many others who may decide to enter the CATV market. Therefore, Centel does not feel that, in a competitive environment, the cross-ownership ban should remain in effect. If some such prohibition is deemed essential, it should be invoked in specific and easily recognizable circumstances where the potential for abuse was a clear and present danger. The circumstantial criteria should consist of specific community sizes, subscriber densities, an inordinately small number of competing media or other standard or combination of standards directed to achieving the policy goal.

The imposition of a more stringent ban or proscription, coupled to a vaguely defined waiver provision, would unduly impede competition and consumer choice. This position affirms the basic premise of S. 611's section 101 and S. 622's section 225: To enable consumers to choose from a wide variety of competing suppliers and services.

S. 611, section 230, and S. 622, section 335(f)(4), reflect concern about the potential for monopolization of the avenues of expression, and in the case of S. 622, for example, it could be argued that section 335(f)(4) prevents a telephone company from being a programmer or system operator even outside of its certificated telephone service area, regardless of section 225(d)(2)(c).

If, as I have suggested, both telephone companies and CATV companies are freed from restraint, rather than the monopolization of avenues of expression, a flourishing of competition will occur. The technological advances of recent times can only add to existing alternatives. In populous areas, broadcast stations, MDS point-to-point services, over-the-air subscription television and the supply of vacant UHF channels are available to provide alternative delivery methods of traditional CATV fare.

Broadband services can be provided by operating telephone companies or other common carriers, in addition to offering entertainment programming. In rural areas, low-power television translators coupled to satellite Earth stations might conceivably be a low-cost alternative to CATV-provided programming. Telephone systems could also compete in the provision of broadband services in rural areas.

Moreover, regardless of the locale, competition in the home video entertainment market is rising from the sale of programming material directly to the consumer. According to International Resource Development, video tape recorders, VTR's, are expected to play a

major role in that market, with over 13 million VTR's in place by 1985.

Finally, if marketplace forces rather than regulation are allowed to govern, fair trade, and antitrust laws will have a larger application to protect the public and competition.

In essence, Centel's position on the provision of broadband services, including cable television, can be summarized by the following points:

One, recent advances in technology have created an opportunity for many suppliers to provide diverse and innovative services, and legislation should enable the proliferation of these services by allowing competition;

Two, there is no demonstrable evidence that competition has the potential to cause economic harm sufficient to warrant regulation beyond existing antitrust laws;

Three, allowing a party to provide both services and facilities will not result in a monopolization of avenues of expression;

And, four, any proscription of provision of broadband services or facilities, including cable television, by telephone operating companies should be imposed only in the most extreme circumstances pursuant to well-delineated criteria.

I would be happy to try and respond to any questions you may have.

[The following information was subsequently received for the record:]

CENTRAL TELEPHONE & UTILITIES CORP.,
Washington, D.C., May 23, 1979.

HON. BARRY GOLDWATER,
Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR SENATOR GOLDWATER: Thank you for your letter of April 30 regarding my testimony before the Senate Communications Subcommittee. I appreciate the opportunity to appear before you and present our Company's views on S. 611 and S. 622.

Pursuant to the request contained in your letter, I will seek to answer below, in order, the five questions which you posed.

Question 1. Because telephone companies have access to virtually every home in the nation, do they have an advantage in competing to provide broadband services?

Answer. Under current technology, the plant which the telephone companies have to gain access to individual customers is generally not now suitable for the provision of broadband services. Telephone companies could not institute such services without investing substantial sums to replace the outside utility plant used for signal transmissions, so there is no immediate tangible advantage.

Unfair advantage can be prevented even where telephone companies do build broadband facilities themselves through the establishment of accounting procedures with appropriate built-in safeguards and regulatory oversight. Along with separate programing service accounts, access to the broadband facilities would also be given to all other programers on a non-discriminatory basis. Since the passage of legislation enabling cable television companies to obtain pole attachments at reasonable rates, the advantage which the telephone companies had for home access due to the rights-of-way obtained as part of telephone construction no longer exists.

Naturally, the access telephone companies have—has given them a marketable reputation—good or bad—depending upon the level of service which they have provided to the customer and this reputation would effect the marketing efforts of the unregulated programing subsidiary. This, of course, is true for almost any business: Warner is known for its movies and recordings and Time for its newsweekly. Mandatory interconnection to the local exchange, combined with the pole attachment rules, give others substantially equal access to telephone company customers. While the telephone company may or may not have an advantage by being a known quantity to the community, we do not consider this potential to be a reason worthy of legislating against telephone company participation in cablecasting.

Question 2. Is this an issue which should be dealt with by this legislation?

Answer. Legislation is needed now because the current FCC cross-ownership rules have discouraged an continue to discourage the deployment of this new technology by foreclosing the opportunity to provide programing. In order to encourage the provision of new and innovative broadband services, the inducement of entertainment programing that has been proven to be economically viable is necessary to help justify the investment risk.

Telephone companies are currently forbidden to operate CATV systems in their own telephone service areas even through completely separate entities that do not utilize telephone company personnel, plant or equipment whose costs are regulated and ratebase related. Since there is no economic competitive advantage, Centel believes that there is no proper rationale for preventing a separate subsidiary from being a cablecaster in the telephone company service area. The existing rule should be abolished. Regulatory uncertainty as to the types of services permissible and forbidden to telephone companies has acted as an additional deterring factor to telephone companies in making the appropriate investments.

The need for legislation in the near term arises because many telephone companies, including Centel, are analyzing the process of deploying lighter fiber optic transmission lines which not only would enable telephone companies to add voice capacity without replacing existing conduit, but will, by the very nature of the transmission medium be able to provide broadband services to customers. Planning decisions will need to be made with respect to installing coaxial cable or fiber optic "drop wires" if telephone companies are to be able to institute broadband services within a reasonable time frame.

Question 3. If we decide to deal with this issue, should AT&T and GT&E be treated differently from the small telephone companies?

Answer. We realize that AT&T poses particular problems for Congress in enacting any generalized communications legislation. In basic fairness, however, we do not believe that any potential benefits which might be gained by other suppliers of broadband services would outweigh the benefit to the public of having AT&T providing transmission facilities for broadband services. AT&T has already gone on record in these proceedings as eschewing any desire to enter the programing business. General Telephone & Electronics does not approach the size that AT&T is and the rationale for regulation of the Bell System seems inapplicable to GT&E. In our view, GT&E which is less than one-sixth the size of Bell, cannot be satisfactorily differentiated from United, Continental or Centel, each of which has assets in the billions, and it should therefore be able to provide broadband services under similar ground rules.

Question 4. Should we legislate an exemption for small telephone companies from any general prohibition that we might adopt for other telephone companies or could a waiver procedure be a more effective device because of its flexibility?

Answer. As noted above, we oppose any generalized prohibition which would preclude telephone companies from providing broadband services. The only area where some type of exemption might be built in to any legislation would be in the requirement that traditional CATV-type programing be provided by a separate entity when the telephone company constructs broadband facilities and that the telephone company be required to provide equal access to other entertainment programers. The main difficulty which we see in the utilization of a waiver procedure is that the advantage of flexibility is offset by the disadvantage of uncertainty and litigation. The scarcity of telephone company-owned CATV systems, despite the FCC's waiver provisions, is indicative of this problem. Whenever a waiver is sought before the Commission, an applicant is faced with the uncertainty with respect to the policies of the Commission or the application of those policies and finally with the possibility that an interested party will enter the case and, by its opposition, subject the company to substantial litigation expense which neither its ratepayers nor its owners could easily afford. Therefore, it is Centel's view that for the legislation to have the appropriate effect, only a minimal level of regulatory discretion should be given.

Question 5. Assuming that we allow the telephone companies to offer broadband services, how can we prevent cross-subsidization between these services and regulated monopoly services?

Answer. Centel is of the opinion that the cross-subsidy issue, one which is constantly raised by competitors, is a smoke screen for fear of an able and competent competitor. State Commissions in conjunction with the Federal Communications Commission have developed elaborate accounting procedures and regular and systematic audits of telephone operating companies to make sure that costs are properly assigned. Our competitors are not so much concerned with the telephone ratepayers shouldering an unfair burden as they seem to be with putting stumbling blocks in the paths of the telephone companies. State Commissions have the power

to make any necessary adjustments and have not hesitated to use that power when they felt compelled to do so. Centel has expressed a willingness to place its programming services in separate subsidiaries and provide comparable access to competitors in those instances where the telephone operating company itself constructs the broadband facilities. Centel does not believe that any additional proscription on telephone companies' operations or organization is necessary.

Naturally, if you, other members of the Committee or your staff members wish to discuss these matters with us further, I would be more than happy to attend such a meeting.

Sincerely,

ALLAN J. ARLOW.

Senator GOLDWATER. Thank you very much.

Well, we have the basis of a little argument right there.

Mr. Koch, you are the last one on the totem pole, so have at it.

STATEMENT OF BILL KOCH, PRESIDENT, CERTIFIED ALARM & SIGNAL CO., ON BEHALF OF THE NATIONAL BURGLAR & FIRE ALARM ASSOCIATION

Mr. KOCH. Mr. Chairman and members of the Subcommittee on Communications, I am Bill Koch, president of Certified Alarm & Signal Co. of Toledo, Ohio. I am treasurer of the National Burglar & Fire Alarm Association.

I appreciate the opportunity to appear today on behalf of the alarm industry. I am here to express our concern about the potential impact that the proposed Communications Act amendments could have upon our industry.

In my testimony today, I shall summarize my written document. I shall touch briefly on four areas of primary concern to us, and request that we be allowed to submit, in addition, a more technical and formal statement of the issues for the record later.

The four issues of major concern to us are: One, unfair competition; two, access to wire transmission paths; three, clarification of definitions; four, frequency allocation.

The alarm industry provides emergency services essential to public safety, health and welfare. The industry safeguards persons and property from fire, criminal attack, and other life and safety hazards.

Alarm companies not only protect major industrial, banking and other commercial customers which are the lifeblood of the Nation's economy, but hundreds of thousands of small businesses, a growing number of residences, military installations, State and Federal office buildings, hospitals, nursing homes, art museums and many other categories of users.

It was estimated in 1976 that more than 2 million premises in the United States utilized remote alarm services requiring telephone circuits. Recent figures indicate that the alarm industry is growing at a compound growth rate of between 10 and 13.5 percent.

At the outset, the alarm industry joins with many others in applauding your effort to encourage competition in the telecommunications industry.

One of the alarm industry's greatest concerns is unfair competition by the telephone industry, primarily by entry into the alarm industry of the largest business in the world, A.T. & T.

In recent years, A.T. & T. has made clear its intention to enter into the alarm business, but has been prevented from doing so only

because of the 1956 consent decree. I would like to quote to you from the A.T. & T. 1978 annual report. The section is entitled "Communications for the Home."

There is no area of our business where we expect to see more dramatic change in the variety and diversity of services than in communications for the home.

Certainly all customers have a common need for basic telephone service. Beyond that, however, our market studies tell us that the needs and desires of residence customers vary widely, depending upon their age, income, lifestyle, location and many other factors.

The needs of the elderly—for example, for swift access to police, fire and medical help—may differ markedly from those of young, single apartment dwellers.

Also, please let me quote Mr. Charles Wohlstetter, chairman of the Continental Telephone Corp., the third largest telephone company:

The Company also is planning for technological changes that will allow greater use of telephone lines, such as through devices that will let customers transmit signals to their homes to operate alarm systems, turn on lawn sprinklers and regulate energy use.

Although we believe that the safeguards established in the bill may protect the alarm industry from predatory conduct by monopoly carriers, we continue to be concerned that the ownership of fully separated subsidiaries by monopoly carriers, as proposed, would still subject such subsidiaries to subtle pressures and influences from parent companies.

We also believe that this committee should consider giving the power to the FCC to require remedies, should there be an adverse competitive impact—after the entry of a fully separated subsidiary into a formerly competitive market.

Another major concern of the alarm industry which we wish to discuss with you today is our continued access to wire transmission paths. Our analysis of S. 611 indicates that there is nothing to prevent local exchange carriers from denying, curtailing, limiting, or discontinuing the private line service which is absolutely essential to the continuation of the vital life safety services provided by the alarm industry. Under section 214 of the Communications Act of 1934, common carrier service, once established, cannot be discontinued without the authority of the FCC.

Although the rates and charges to the alarm industry are largely governed by state public utility commissions, the monopoly carriers have not been able to withdraw or discontinue service to the alarm industry under present law without approval of the FCC and State public utility commission.

For the most part, under the new legislation, the type of private line service furnished to alarm companies would be provided by local exchange carriers. Under amended section 231(b) of S. 611, the FCC may impose no requirements on any exchange carrier other than specific exceptions. The exceptions do not protect the alarm industry from having the facilities it needs curtailed, limited or provided at unreasonable rates.

Section 205(b) gives the FCC authority to "impose such other requirements as the Commission deems necessary to ensure the provision of an essential public service."

As we read the bill, these provisions would not apply to local exchanges. We respectfully urge the committee to require State commissions to issue regulations which require all telecommunica-

tion carriers to provide essential public and private services necessary to protect persons from fire, criminal attack, and other life safety hazards, and also to protect property.

We further submit that the FCC should reserve to itself the right to require all carriers, including local exchange carriers, to provide necessary telecommunications service for such public and private services at reasonable and affordable rates in the event that State commissions fail to do so.

The alarm industry is well aware of the delicate balance between Federal and State regulation of telecommunications and the earnest desire of Congress to deregulate telecommunications and encourage competition. The alarm industry supports these goals, but during the transition period, we respectfully urge that Congress not lose sight of industries such as ours that are really totally dependent on wire services provided, for the most part, by monopoly carriers.

We are not addressing a speculative possibility. A.T. & T. and its subsidiaries have served notice upon the alarm industry that they intend to file tariffs which would curtail or eliminate the subvoice grade private line service essential for the transmission of remote alarm signals and they would impose other restrictions prohibiting the use of ground return from metallic circuits.

The telephone company contends that, although in the past decade subvoice grade metallic lines were normally furnished to the alarm industry, such lines have become increasingly scarce due to the Bell System conversion of its interoffice trunking facilities to extensive AC carrier voice grade telephone channels.

In the 1960's, alarm companies were advised by Bell System representatives that metallic circuits were becoming increasingly scarce because copper wire was scarce. When the copper wire shortage passed, the Bell System acknowledged that the real reason it was converting trunking facilities to AC carrier was because they were able to provide from 24 to 96 transmission paths over a single line by utilizing AC carrier on the line.

At the present time, the overwhelming investment of alarm companies and alarm company customers using telephone lines in both plant and field equipment is built around the use of dedicated metallic facilities and DC current.

In some areas of the country, central station companies have already been advised that metallic facilities would not be available. If the metallic facilities are curtailed or eliminated before the alarm industry has an economically feasible alternative and the opportunity to finance a changeover, such action will pose great economic, as well as operational burdens on alarm companies and their subscribers. The result is that many subscribers may be forced to accept less effective means of protection.

To emphasize the serious dimensions of the problem, we bring to your attention the following: In August of 1976, it was estimated that at least 350,000 separate telephone circuits were utilized by remote alarm communications. We believe that figure is fast approaching the one-half million mark.

The number of subscribers placed on such circuits depends upon a number of factors such as geographic location, distance between subscribers, the type and extent of equipment utilized by the alarm

company, and the policy or tariffs of the telephone company providing the circuits.

During the past 10 years, the alarm industry has been intensely negotiating with A.T. & T. to forestall A.T. & T.'s application for tariffs, which would effectively eliminate the ability of alarm companies to provide remote services until it becomes technically feasible and practically affordable to switch over to alternative systems. Such a transition process is likely to take between 5 and 10 years.

We recommend and urge that, consistent with the general intent and purpose of the amendments proposed in S. 611, the vital services provided to more than 2 million separate premises and affecting the lives of millions of Americans be afforded recognition and protection as essential services necessary to the safety of life and property in any final amendments of the Communications Act. The continued access to telephone circuits is imperative.

Definitions in the act are also a concern of the alarm industry.

We raise the question whether or not the definition of "information services" includes or excludes "process control." If telecommunications carriers should be permitted to expand a communication system into the type of process control which, in the case of the alarm industry, has traditionally been an integral part of alarm services, then a substantial portion of alarm company revenues would be diverted to telecommunication carriers.

The FCC has labored for years over its second computer inquiry without coming to any conclusions over just where telecommunication ends and information services or data processing begin. We fervently hope that this legislation will finally accomplish this distinction.

We also believe there is an oversight in the frequency allocation portion of the act, such as the possibility of nonessential use of radio, e.g., "CB", above the protection of human life and property. I would ask that we be allowed to submit, for the record, our views and opinions on the clarification of definitions and frequency allocation.

I would like to state again that the alarm industry is totally dependent upon the telephone industry for transmission facilities or transmission paths to transmit alarm signals from the alarm company subscriber to the designated point of reception. The telephone company in general, and A.T. & T. most particularly, primarily control these transmission paths and effectively control the price for providing these services.

Given this situation, entry by telephone companies and other monopolies into the alarm industry should be tightly controlled to prohibit predatory pricing and anticompetitive actions.

The alarm industry presently has no viable alternatives and if the telephone industry is allowed free access into the alarm industry, the fate of the alarm industry will be sealed.

This concludes my remarks this afternoon. I thank you again for allowing me this opportunity to speak to you and air our concerns. I look forward to discussing and debating these issues with my panel colleagues.

[The statement follows:]

STATEMENT OF BILL KOCH ON BEHALF OF THE ALARM INDUSTRY

Mr. Chairman, members of the Subcommittee on Communications, I am Bill Koch, President of Certified Alarm and Signal Company of Toledo, Ohio. I am Treasurer of the National Burglar and Fire Alarm Association. I appreciate the opportunity to appear before you today on behalf of the alarm industry. I am here to express our concerns about the potential impact that the proposed Communications Act Amendments could have upon our industry.

Our two greatest concerns center on the entry of the largest business in the world—A.T. & T.—into the alarm business, and the continued access by alarm companies of affordable transmission paths controlled by telephone companies.

At the outset, I join with the majority of others in applauding your efforts to bring the 1934 Communications Act fully into the Twentieth Century. We are hopeful that the issues raised today will become modifications to these bills at the appropriate time.

I. THE ALARM INDUSTRY: WHO WE ARE, WHAT WE DO, HOW WE DO IT

The alarm industry provided emergency services essential to public safety, health and welfare. The industry safeguards persons and property from fire, criminal attack and other life safety hazards.

Alarm companies not only protect major industrial, banking and multistate commercial customers which are the lifeblood of the Nation's economy, but hundreds of thousands of small businesses, a growing number residences, military installations, state and federal office buildings, hospitals, nursing homes, art museums and many other categories of users.

Security systems are often mandated by state and federal laws, e.g., bank protection, storage of narcotics, nuclear energy facilities, defense installations, and civilian defense production. In many geographic areas and for certain categories of risks, insurance companies will not write fire or crime insurance unless appropriate alarm systems are installed on the premises to be insured.

In addition, we also provide vital monitoring services such as remote medical alert for the elderly, and such.

Many Fire Marshals and Fire Chiefs throughout the country have acknowledged that fire alarm systems provided by the burglar and fire alarm companies provide the only early warning systems available to detect fires early enough to notify the fire departments and to protect life and property from the results of the fire.

Local police department studies have pointed out the tremendous beneficial effect of burglar alarm systems installed in private residences and businesses and the benefit to the community and to the police agencies in deterring the crime of burglary as opposed to those situations where no burglar alarms exist.

A recent, LEAA-funded study found that alarm systems are not only highly effective in reducing the financial loss due to burglary, but that burglar alarms offer the only proven solution if a reduction in the amount of unreported crime and an increase in the offender arrest rates are desired. The report went on to say, "It appears that the only chance that the small business particularly, and the homeowner has, is to install an alarm system."

The alarm industry itself is comprised of about 6,000 companies in the United States which specialize in installing, servicing, and/or monitoring alarm systems. Several thousand more offer limited alarm services but specialize in other security services. The field is supplied by about 600 manufacturers.

Approximately 95 percent of the 6,000 specialize in burglar alarm installation and/or monitoring. About 5,000 companies focus on local alarm protection for both burglar and fire, though many of these now provide modified central station protection with digital and tape dialers, which report emergencies either to an answering service or directly to the public authorities.

The remaining 1,000 companies manage central stations which monitor the burglar, fire and industrial processes alarms they install. Most are located in major urban centers.

A unique feature of this industry is its thriving small business segment. Not a single company reported gross revenues in excess of \$300 million in 1977. Only four exceeded \$50 million.

Another unique feature is that the businesses tend to be locally-owned and operated. Their livelihood depends on their stature in the eyes of the public and the life safety institutions in the localities they serve.

We believe the present structure of the industry, especially the large small business segment, is extremely important in the consideration of any legislation amending the 1934 Communications Act.

In providing these basic but essential services, we must point out that the alarm industry is primarily dependent on the telephone company, and to a lesser extent

requires radio communication. Alarm companies must lease their private lines from the telephone company in order to transmit the alarm signals from the alarm company customer's location to the alarm company's central station, the police department, fire department or wherever the destination the alarm signal is to terminate.

Radio communication is required to dispatch personnel to the alarm site after an alarm signal is received and to notify law enforcement or fire officials of the action in progress. In addition, radio frequencies can be used to supplement telephone company leased lines for the transmission of alarm signals.

In my opening statement today, I shall touch briefly on the primary areas of real concern to us, and would ask that we be allowed to submit, for the record, a more complete and formal statement of the issues at a later date.

Our analysis of the proposals show basically four problem areas:

1. Competition from the telephone company; i.e., unfair competition by monopoly telecommunications carriers entering the alarm business and other non-telecommunications markets in a predatory manner.
2. Access to lines; i.e., access to wire transmission paths from local as well as interexchange telecommunications carriers at reasonable and affordable rates.
3. Confusing, uncertain or incomplete definitions.
4. Appropriate and secure frequency allocation.

The first two issues, competition and access, are thoroughly intertwined.

II. UNFAIR COMPETITION FROM MONOPOLY COMPANIES

A major concern of the alarm industry has been that the monopoly common carriers would enter into the alarm industry and at the same time restrict or make unaffordable the utilization of telephone lines by alarm companies. During the past few years, AT&T and some of its operating companies have requested drastic rate increases throughout the country for the facilities it has leased to the alarm industry. It has also been seeking to impose tariff restrictions which would effectively cut off alarm companies off from the telephone lines they must have to provide remote signaling and monitoring services.

It is well known within the alarm industry that the Bell System has long wanted to get into the alarm business, but has been prevented from doing so only because of the 1956 Consent Decree. I would like to quote to you from the AT&T 1978 Annual Report:

Communications for the home

"There is no area of our business where we expect to see more dramatic change in the variety and diversity of services than in communications for the home.

"Certainly all customers have a common need for basic telephone service. Beyond that, however, our market studies tell us that the needs and desires of residence customers vary widely, depending upon their age, income, lifestyle, location and many other factors.

"The needs of the elderly—for example, for swift access to police, fire and medical help—may differ markedly from those of young, single, apartment dwellers. Other residence customers, active in business and community work, may want in their homes the kind of flexible communications—conferencing, call forwarding, automatic call-back when lines are busy—that are characteristics of modern office communications systems."

It is also well known that AT&T has continually—almost traditionally—used its more profitable operations to subsidize its less profitable ones, enabling it to effectively underwrite its own operations and undercut its competition in those areas.

The bill would allow the FCC to open new markets to competition. AT&T and other category II carriers are specifically prevented from competing directly, but must set up fully separated subsidiaries.

Let me emphasize, we would naturally be concerned with AT&T's competing with us—all things being equal. But because of the size and present monopoly position of AT&T, we are convinced (and I believe rightly so) that all things can never be equal, even under the safeguards and limitations which this bill provides.

The requirements of S. 611 are a first attempt to ensure effective competition. The concept of separate control in the process of deregulation is one which may be viable; however, the principal obligation must be to make certain that alarm companies are not forced to compete with AT&T under existing circumstances. As indicated, alarm companies are totally dependent upon telephone company leased lines and even the establishment of the "Category II" carrier raises issues as to whether or not alarm companies can ever compete with an AT&T.

We believe that more is necessary to prevent monopoly telephone carriers from entering into the alarm business in a predatory and monopolistic manner. Ownership of fully-separated subsidiaries by monopoly carriers, as proposed in the legisla-

tion, would still subject such subsidiaries to subtle pressures and influences from parent companies. In some cases, only a total or full spin-off of such subsidiaries could assure that nontelecommunications markets, such as the alarm industry would remain truly competitive.

Another example arises in current state rate-making proceedings. There, telephone companies are required to separate costs to justify tariffs. They have not been too successful. We question whether they will be so now.

Unless additional protection combined with strong enforcements is afforded within the proposed legislation, AT&T would be put in a posture to immediately destroy the competing alarm companies. We hope that effective controls to ensure fair competitive entry of a Category II carrier subsidiary into the alarm business can be established; if in fact this is allowed at all.

We question whether they really can.

III. ACCESS TO TRANSMISSION PATHS

Our second major concern is that this bill would allow carriers to deny to our industry the availability of necessary wire transmission paths. We are concerned that, as a vital user of telephone lines, we may be effectively cut off from available lines at affordable rates.

Our analysis of S. 611 indicates that there is nothing to prevent local exchange carriers from denying, curtailing, limiting or discontinuing the private line service which is absolutely essential to the continuation of the vital life safety services provided by the alarm industry.

Under Section 214 of the Communications Act of 1934, common carrier service—once established—cannot be discontinued without the authority of the Federal Communications Commission (FCC). Although the rates and charges to the alarm industry are largely governed by state public utility or public service commissions, the monopoly carriers have not been able to withdraw or discontinue services to the alarm industry under present law without approval of the FCC and/or state commissions.

For the most part under the new legislation, the type of private line service furnished to alarm companies would be provided by local exchange carriers. Under amended Section 231(b) of S. 611 the FCC may impose no requirements on any exchange carrier other than those exceptions specifically set forth. These exceptions do not protect the alarm industry from having the facilities it needs curtailed, limited or provided at unreasonable rates.

It is stated that a primary purpose of the bill is “. . . for the purpose of promoting safety of life and property through the use of telecommunications; . . .”. As already discussed, it is the purpose of the alarm industry to do just that.

Section 205(b) gives the FCC authority to “impose such other requirements as the Commission deems necessary to ensure the provision of an essential public service.” As we read the bill, these provisions would not apply to local exchanges.

We ask that this legislation direct the state commission to require all carriers (Category I and Category II) to provide access to their facilities in order that essential public and private services can be made available.

We further submit that the FCC should reserve to itself the right to require all carriers, including local exchange carriers, to provide necessary telecommunications service for such public and private services at reasonable and affordable rates in the event that state commissions fail to do so.

We have developed language which we believe will remedy this apparent oversight, which we will submit separately. The legislation should prescribe access to local exchange lines or alternative transmission paths for essential services, leaving the question of reasonable charges to the FCC or the states.

The alarm industry is well aware of the delicate balance between federal and state regulation of telecommunications and the earnest desire of Congress to deregulate telecommunications and encourage competition. We support these goals, but during the transition period we respectfully urge that Congress not lose sight of industries such as ours that are really totally dependent on services provided, for the most part, by monopoly carriers.

At the present time, there is no readily available, convenient method of transmitting alarm signals, other than that of local phone company lines. In a few areas coaxial cable may be an alternative possibility which the alarm industry is now exploring with the cable industry. At present, the high level of security which we can provide on telephone lines is not yet feasible over cable. As feasible and economical methods and alternatives develop—and as the competition envisioned by the bill evolves—We will be preparing to utilize and convert to other methods of signal transmission. But for now, and for the foreseeable future, this is just not the case.

We need a guarantee of local private line service so that we may be able to offer our customers this necessary service at reasonable rates. Until a competitive environment of alternative transmission paths has developed, as determined by the FCC or state commission, the prohibition against discontinuance—and a directive for continued access—should be grandfathered into any new legislation.

IV. CLARIFICATION OF DEFINITIONS

While we believe we understand the basic intent of the drafters of this legislation, we feel that some of the definitions and language of particular sections may not be actually accomplishing the intended goals.

We have set forth the problems which the alarm companies have encountered, and the problems which we anticipate. In addition, it is difficult to determine how the proposed legislation would fully impact the alarm companies because of current wording of some definitions.

For example, does the definition of information service include or exclude "process control?" In its Second Computer Inquiry, Docket 20828, the FCC defined process control as "applications [which] include the use of electronic equipment to monitor and control some process which is occurring on a continuing basis—such as nuclear-powered generation stations, an electric power distribution grid, an automatic machine tool, or a fire detection and control system".

We would hope that process control as defined by the FCC, is part of an "information service" (or at least a nontelecommunication service) and that process control (except as used to switch or transfer voice messages) is not incidental to or an integral part of a telecommunication system or the management of a telecommunication system. Thus, a Category II carrier should be required to create a fully-separated subsidiary in order to provide a process control system, equipment or service. At present this is not clear.

Conversely, is the definition of telecommunications service drawn narrowly enough to exclude the type of "information service" which an alarm company provides? An alarm system is clearly different from other types of information services in that:

1. The transmission of the alarm signal is an integral part of the service,
2. The alarm company must control and supervise such signal transmission.

If telecommunication carriers should be permitted to expand a communication system into the type of "process control" (defined by the FCC) which, in the case of the alarm industry, has traditionally been an integral part of alarm services, then a substantial portion of alarm company revenues would be diverted to telecommunication carriers. If a telecommunication carrier, whether interexchange or local, desires to engage in process control, as defined by the FCC, then it should be required to do so by a fully-separated entity.

We would further point out that if telecommunication carriers provide and control the entire end-to-end transmission of alarm signals, then a third party becomes involved in the security of the alarm system. Under existing alarm signal transmission systems, alarm companies or their customers control, and are principally responsible for, the security of the transmission system involved. This is critical to the safety of people and property.

The FCC has labored for years over its Second Computer Inquiry without coming to any conclusions over just where telecommunications ends and "information services" or "data processing" begin. We fervently hope that this legislation will finally accomplish this distinction.

Another problem arises in § 203(g) of S. 611. It is possible to interpret that section as authorizing the FCC to classify an alarm company which utilizes leased local exchange telecommunication facilities as a Category I carrier: "Any entity which provides a telecommunication service either as a separate or integral part of an information or other non-telecommunication service shall be deemed a telecommunications carrier with respect to such telecommunications service."

In this connection no distinction is made between information service companies which "lease" telecommunication services or those which actually resell such services.

Amended Section 203(g) is confusing because although it appears to be generally referring to intercity services, the first part of the section does not distinguish between local and intercity exchange services. Hypothetically, a central station leasing intercity services could even be classified as a Category II carrier if it was not found to be subject to effective competition in the relevant geographic area.

We do not believe that it was the intention of the drafters to regulate, as carriers, entities such as alarm companies unless such companies actually set up or operate a separate telecommunication facility. The Committee may wish to clarify paragraph (g) as a technical matter.

V. FREQUENCY ALLOCATION

We would call your attention to an oversight existing in policies that have arisen under the present Communications Act. The present Act, which established the justification for use of the radio spectrum in terms of the "public interest, convenience or necessity," has permitted the growth of a policy, within the non-federal portion of the spectrum, that places the interim value of a non-essential use of radio (e.g., the "CB") above the essential service of protecting human life and property. Under the 1934 Act, the priority rights of federal agencies (regardless of urgency of need) were recognized. No such policy was developed to recognize the needs of private businesses such as alarm companies which provide security and protection services. This omission could be corrected by clear policy guidance by Congress in the deliberations of the Spectrum Commission.

The legislation calls for five members of the fifteen-person Commission who represent private users of the spectrum. We would ask that alarm security industry representatives be one of the named examples listed, as we not only are significant users, both the purpose for which we use frequencies is so vital to community safety.

In sum, I would like to state again that the alarm industry is totally dependent upon the telephone industry for transmission facilities or transmission paths to transmit alarm signals from the alarm company subscriber to the designated point of reception. The telephone industry in general, and AT&T most particularly, totally control these transmission paths and effectively control the price for providing these services.

Given this situation, entry by telephone companies and other monopolies into the alarm industry should be tightly controlled to prohibit predatory pricing, and anti-competitive actions.

This committee must make certain that the necessary safeguards are instituted to avoid the possibility of this occurring, so that we can continue to protect the lives and property of millions of Americans from fire, burglary and other dangerous hazards. The alarm industry presently has no viable alternatives and if the telephone industry is allowed free access into the alarm industry, the fate of the alarm industry will be sealed.

This concludes my remarks this afternoon. I thank you again for allowing me this opportunity to speak to you and air our concerns. I look forward to discussing and debating these issues with my panel colleagues.

[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question. On pages 5 and 6 of your prepared statement you note four basic problem areas of concern to the alarm business—competition from the telephone company; access to lines; confusing definitions; and appropriate and secure frequency allocations. Do you have specific language changes or amendments to offer the Committee which would take care of each of these problems, and if not, will you submit such language for the record?

Answer. The NBFAA has developed language which addresses the problem areas of S. 611. We have attached these suggested amendments to our answers.

Question. What is the basis for your position that the telephone industry would deny the alarm industry access to their private line facilities when by leasing or offering such facilities they obtain income?

Answer. AT&T has made clear its intention to enter into the alarm business in presentations before alarm industry association meetings and in filings in FCC Docket No. 20828, particularly with respect to the residential alarms field. AT&T and many of its operating companies are attempting to force the alarm industry to utilize an advanced and prohibitively expensive technology which is simply not required for the transmission of most alarm signals and which technology does not, at present, offer the high degree of line security required by many alarm systems.

Some further background is required to understand AT&T's conduct. In the late 1960s AT&T advised alarm companies that it intended to eventually convert all of its metallic facilities¹ to carrier circuits capable of carrying up to 94 transmission

¹ Most telephone circuits consist of cable with copper wire. The term metallic circuits means wire pairs which run directly from a protected premise to a central station or public police or fire communication center and which are dedicated to the use of a limited number of subscribers. Carrier circuits connect numerous telephone subscribers to wire centers where calls are routed, switched and multiplexed to the station dialed. In many areas and in long distance calls,

Footnotes continued on next page

paths over a single line. It led the alarm industry to believe that it would develop technology to permit alarm companies to have continued access to transmission lines utilizing advanced carrier techniques. When by the early 1970s AT&T did not develop such technology, several manufacturers of alarm systems hardware developed alarm transmission systems designed to utilize carrier (as opposed to metallic) circuits. One manufacturer of alarm systems demonstrated that if the telephone company would provide necessary bridging (which did not require sophisticated electronics) that it could provide economical transmission of alarm signals over carrier circuits. This company was thwarted, however, by AT&T and certain operating companies to such an extent that it was forced to file an antitrust action against AT&T which is now pending in the federal courts. The cost of fighting predatory conduct by AT&T is so enormous that few companies in the industry can afford to take on Ma Bell under existing antitrust laws.

The present course of conduct by AT&T has been to develop technologically advanced systems for the transmission of alarm signals which are far beyond the normal requirements of the alarm industry and which have been proven to be so costly that they are not affordable in the majority of cases. While AT&T was developing its sophisticated transmission system it simultaneously developed a proposed specification relating to the use of metallic circuits that is so restrictive that for all practical purposes it would deny the alarm industry access to the metallic circuits upon which it is primarily dependent. To discourage alarm companies from purchasing advanced transmission equipment designed for use with telephone carrier circuits from independent manufacturers of alarm transmission equipment and to deter the alarm industry from seeking legal or FCC action against it, representatives of AT&T repeatedly stated orally and in writing that it would not attempt to impose the proposed restrictions on metallic circuits until the alarm industry had economically feasible alternatives. Now that AT&T has developed its sophisticated alternative it has decided to file the proposed restrictions on metallic circuits as tariffs in some states and has stated its intention to do so throughout the United States. However, the new AT&T transmission system is not economically feasible except in certain rare instances. Moreover, it appears that the system will not provide the high degree of line security required for Underwriters' Laboratory certification. Finally, even if the new AT&T transmission system were economically feasible, it would require an enormous investment by alarm companies and their customers in a very short period of time to convert existing alarm systems so that they would be compatible with the new AT&T alarm transmission facility.

Question. Doesn't your major concern go beyond the entry of just AT&T into the alarm business and include any current telecommunications carriers going into the business?

Answer. Our major concern does indeed go beyond the entry of just AT&T into the alarm business.

In any major geographic area in which a major independent telephone company such as GTE operates, such company would be able to engage in the same predatory practices as does AT&T if it desired to enter into the alarm business because it could subsidize its entry into the alarm business with profits from its regulated telecommunications services and at the same time restrict the use of metallic circuits by unreasonable tariff restrictions or rates.

Entry by any major monopoly carrier into the alarm business poses a grave threat to the competitive structure of the alarm industry as long as such carriers have full control over an essential component of the alarm business—the transmission paths.

Question. On page 17 you indicate that “. . . entry by telephone companies and other monopolies into the alarm industry should be tightly controlled. What “other monopolies” are you referring to?

Answer. The alarm industry would also be concerned if *any* telecommunications carrier other than a telephone company obtains a monopoly over telecommunications services in any substantial geographic area. If such a monopoly denied the alarm industry access to the use of economical transmission paths it could enter into the alarm business and destroy existing alarm businesses.

Question. You also state that the alarm industry is presently *totally dependent* upon the telephone industry for transmission facilities. How long do you anticipate that this total dependence will last?

Footnotes continued from last page

telephone messages may be to radio frequencies and transmitted by microwave relay stations. Standard alarm signal transmission systems cannot operate over carrier circuits and require point-to-point dedicated lines.

Answer. We have pointed out that at the present time the alarm industry is almost totally dependent upon telephone company circuits. A state-of-the-art technology does exist with respect to coaxial cable and radio frequency transmission to provide alternative transmission paths for alarm signals. At the present time, however, the former technology has not evolved to such an extent that it offers a feasible alternative. The obstacle to utilizing radio frequency for alarm signal transmission relates to a cart-before-the-horse problem. No alarm company and no manufacturer of radio frequency transmission equipment will make the substantial investment required to design and manufacture equipment which can be used by the alarm industry for point-to-point transmission of alarm signals until the alarm industry is assured that the FCC will allocate secure and adequate radio spectrum for alarm industry use. Although it has made some minor inroads in this regard before the FCC, it simply has been unable to obtain an adequate classification and allocation from that agency.

The telephone industry has endeavored to portray the alarm industry as being obsolete and technologically inept. On the contrary, the alarm industry has developed many sophisticated state-of-the-art sensor devices and signal transmission techniques. Many of these systems are now employed with respect to high-risk targets such as jewelry stores, banks, pharmacies, furriers and defense installations. Research has indicated, however, that many businesses and residences which are not high-risk targets can be adequately protected by relatively simple tried and tested alarm systems. Indeed, LEAA-funded studies indicate that an overwhelming number of burglars interviewed stated that they avoided businesses and residences equipped with effective alarm systems. This study further indicated that less than 5 percent of burglars indicated a willingness to attempt to compromise the more sophisticated alarm systems.

Accordingly, the alarm industry submits that the effect of telephone company conduct is to force lower and middle income businesses and residences to accept signal transmission systems which they do not need and which they cannot afford.

In conclusion, we submit that until the alarm industry can reasonably foresee the degree of cooperation that it will obtain from state and federal regulatory agencies in developing economically feasible alternatives to telephone circuits, it is almost impossible to predict how long industry dependence upon telephone common carriers will last.

Question. On page 7 you state that while telephone companies are required to separate costs to justify tariffs in current state ratemaking proceedings, they have not been too successful. Why not, and what is your basis for this statement?

Answer. The alarm industry statement referred to in your Question No. 6 needs to be clarified so that an appropriate answer to you can be made. Alarm companies requiring dedicated private line metallic circuits (non-voice grade lines) are being deluged with telephone company tariff applications for rate increases ranging from 37 percent to 300 percent. Sometimes counsel for alarm companies in proceedings before state regulatory commissions can force a compromise or reduction of these rate increase applications by merely requesting that the state commission require telephone companies to break down and justify their costs. In many instances, however, telephone company recordkeeping procedures aggregate all private line service costs and are so complex that they are undecipherable even to telephone company witnesses. Attorneys for alarm companies are forced to attempt to analyze applicable costs by expensive deposition and discovery procedures.

In general, telephone company tariffs and cost justifications have not taken into account the following factors:

A. To a large extent, the cost for existing metallic lines should be treated as a historical embedded cost because they have been paid for a depreciated. Moreover, there are relatively small maintenance costs with respect to such lines as compared to carrier circuits.

B. Many private line services require sophisticated electronics, including repeaters and time and frequency division multiplex facilities. The alarm industry provides its own dc power source which it generates over telephone company lines and does not require the telephone company switching network to provide its service.

C. AT&T is attempting to tariff and has successfully tarified unreasonable restrictions on the use of metallic circuits by alarm companies. This has been done even though telephone company officials have made representations that they would not impose such restrictions on the use of metallic circuits until the alarm industry had viable and economically feasible alternatives to low baud metallic private line service for the transmission of alarm signals. Moreover, AT&T has agreed with Western Union (which also uses metallic lines) to phase out metallic lines for interexchange use by 1983.

The experience of alarm companies is that although they may, in a few cases, be able to reduce telephone company applications for enormous rate increases before state regulatory commissions, shortly thereafter the telephone company will turn around and file new tariffs for substantial rate increases.

Accordingly, the alarm industry is faced with constant efforts by AT&T operating companies throughout the United States to impose excessive and unreasonable tariffs on private line metallic service while, at the same time, endeavoring to restrict the use of that service to such an extent that it has and will effectively deny access to such lines by alarm companies and alarm company customers.

Question. On page 11 you "... urge that Congress not lose sight of industries such as ours that are really totally dependent on services provided, for the most part, by monopoly carriers." What other industries do you have in mind?

Answer. Companies providing automatic reminder/wake-up services, Muzak, a host of industries providing process control services, such as monitoring or controlling energy consumption, remote utility meter reading, companies providing data transmission of airline and car rental reservations and banking services including electronic fund transfer, to name a few.

6/25/79

SUGGESTED AMENDMENTS TO
S.611
PROPOSED BY
ALARM INDUSTRY TELECOMMUNICATIONS COMMITTEE*

Sec. 103 (Definitions)
Page 5
Line 15

Insert a new definition "(9)" as follows:
"The term 'essential security services' means public services or systems provided by police and fire agencies or private services or systems provided by businesses engaged in protecting persons and property from fire, smoke, criminal attack and other hazards which threaten the security of life, health and property."
Renumber remaining definitions.

Sec. 103
Page 8
Line 22

Insert a new definition 26: "'Process control service' for the purpose of Part I of this Act means the use of electronic equipment to monitor or control the environment of a customers premises or to monitor or control some process which is occurring on a continuing basis at a customer's premises such as fire detection or control systems, burglary and robbery detection or control systems, hazardous industrial processes or energy conservation monitoring or control systems."
Renumber remaining definitions.

Sec. 103(9)
NEW

(9) The term "essential security services" means public services or systems provided by police and fire agencies or private services or systems provided by businesses engaged in protecting persons and property from fire, smoke, criminal attack and other hazards which threaten the security of life, health and property.

Sec. 103(26)
NEW

(26) "Process control service" for the purpose of Part I of this Act means the use of electronic equipment to monitor or control the environment of a customers premises or to monitor or control some process which is occurring on a continuing basis at a customer's premises such as fire detection or control systems, burglary and robbery detection or control systems, hazardous industrial processes or energy conservation monitoring or control systems.

* New proposed language has been underlined. Deleted language is indicated by hyphens.

S.611

NOTE: This new definition of process control is necessary because the definition of "information service" set forth at Section 103 (15) describes relatively passive data processing functions. The services provided by alarm companies include systems which not only store and transfer information but signal or react to changes or stimuli in the ambient environment of the customers premises. Some systems may be automatically activated to change or modify emergency conditions detected. For example, the detection of smoke or fire may result in a return signal activating a sprinkling system at the premises. The detection of an unauthorized intrusion into a protected space could result in the transmission of an alarm signal to a public or private communications center to which policemen or private guards may respond. The detection of a change in humidity or temperature at food warehouses or with respect to a chemical or industrial process may result in the activation of systems or personnel to correct such changes. The foregoing functions are clearly more than merely information services.

S.611

Sec. 103
Page 12
Line 9

After the word "services" and before the word "shall", insert the following:
"or in providing process control services."

NOTE: This change is to make it clear that businesses engaged solely in process control services are not to be deemed carriers with respect to any provision of this bill.

Sec. 205(b)
Page 30
Line 22

After the word "public" and before the word "service" insert "or security".

NOTE: Alarm companies are primarily dependent upon local carriers to provide alarm signal transmission services. The purpose of this amendment is to ensure that the commission has authority to require either a Category I or Category II carrier to provide telecommunications systems to both public and private providers of essential security services where such providers have no alternative means of signal or data transmission.

Sec. 103(35)

"(35) 'Telecommunications carrier' or 'carrier' means any person or any subsidiary of such person, including any government or quasi-government entity engaged in the offering of telecommunications services for hire; but a person engaged in broadcasting or in marketing telecommunications equipment or electronics equipment or in providing information software or information services or in providing process control services shall not, insofar as such person is so engaged, be deemed a carrier.

Sec. 205(b)

(b) ... The Commission may also prescribe joint operations among Category II carriers, or among such carriers and Category I carriers, award an exclusive franchise to one or more carriers or impose such other requirements as the Commission deems necessary to ensure the provision of an essential public or security service.

S. 611

Sec. 210(b) (Modifying Section 208 of
Page 35 the 1934 Act)
Line 14

Add new paragraph (c) and subparagraphs
(1) and (2) to Section 208 as follows:
"(c)(1) Every Category I or Category II
carrier shall, through lease, resale
or by individual contract make available
upon reasonable request therefore,
exchange telecommunications facilities or
services for use by essential public or
security services and shall establish
just reasonable and nondiscriminatory
tariffs for and in connection with such
services, and any such tariff that is
unjust or unreasonable or that results
in an unjust or unreasonable discrimina-
tion, preference, advantage with
respect to any person, class of persons,
or locality for or in connection with
like telecommunications services is
hereby declared to be unlawful "

"(2) It shall be the responsibility
of the State commission in its regula-
tion of exchange telecommunications to
establish appropriate rates, terms and
conditions necessary to carry out and
enforce the requirements of this
paragraph."

Sec. 210(b) (Adding new paragraph C and
NEW subparagraphs (1) and (2) to
Section 208 of the 1934 Act)

(c)(1) Every Category I or Category II
carrier shall, through lease, resale or by
individual contract, make available upon
reasonable request therefore, exchange tele-
communications facilities or services for
use by essential public or security services
and shall establish just, reasonable, and
nondiscriminatory tariffs for and in
connection with such services, and any such
tariff that is unjust or unreasonable or that
results in an unjust or unreasonable dis-
crimination, preference, or advantage with
respect to any person, class of persons, or
locality for or in connection with like
telecommunications services, is hereby
declared to be unlawful.

(2) It shall be the responsibility of
the State commission in its regulation of
exchange telecommunications to establish
appropriate rates, terms and conditions
necessary to carry out and enforce the
requirements of this paragraph.

S.611

Sec. 230
Page 60
Line 16

Add a new paragraph (c), to read as follows: "(c)(1) It shall be the responsibility of each state (or any agency or instrumentality thereof) by statute or by regulation to ensure that exchange carriers provide necessary telecommunications services and facilities at reasonable and affordable rates and upon reasonable terms and conditions for essential security services."

"(2) No exchange carrier shall discontinue or modify any existing telecommunications service necessary for essential security services without the express approval of the applicable State agency or instrumentality."

"(3) In the absence of state action pursuant to paragraphs (1) or (2) of this subsection, the Commission, upon its own motion or upon petition of any interested party, by regulation may impose requirements on any exchange carrier to ensure the provision of telecommunications services or facilities at reasonable and affordable rates and upon reasonable terms and conditions for essential security services."

Sec. 230(c)
NEW

(c)(1) It shall be the responsibility of each state (or any agency or instrumentality thereof) by statute or by regulation to ensure that exchange carriers provide necessary telecommunications services and facilities at reasonable and affordable rates and upon reasonable terms and conditions for essential security services.

(2) No exchange carrier shall discontinue or modify any existing telecommunications service necessary for essential security services without the express approval of the applicable State agency or instrumentality.

(3) In the absence of state action pursuant to paragraphs (1) or (2) of this subsection, the Commission, upon its own motion or upon petition of any interested party, by regulation may impose requirements on any exchange carrier to ensure the provision of telecommunications services or facilities at reasonable and affordable rates and upon reasonable terms and conditions for essential security services.

S. 611

Sec. 306
Page 102
Line 21

Add a new Section 306 as follows:
Subsection (c) of section 303 of the 1934 Act, as amended is further by changing the semi-colon to a colon and adding at the end thereof the following: "Provided, however, That in making any frequency allocation, or reallocation, affecting mobile service frequencies, the Commission shall insure spectrum resources adequate to meet the reasonable present communications needs, including provisions for future growth, of public and private security agencies. For the purpose of this section, public and private security agencies include traditional governmentally supported agencies, such as police and fire services and private organizations furnishing security services to the public, such as burglar or fire alarm services;"

Sec. 306

Section 303(c)

Assign bands of frequencies to the various classes of stations, and assign frequencies for each individual station and determine the power which each station shall use and the time during which it may operate: Provided, however, That in making any frequency allocation, or reallocation, affecting mobile service frequencies, the Commission shall insure spectrum resources adequate to meet the reasonable present communications needs, including provisions for future growth, of public and private security agencies. For the purpose of this section, public and private security agencies include traditional governmentally supported agencies, such as police and fire services and private organizations furnishing security services to the public, such as burglary or fire alarm services;

Ms. MANNING. I would like to apologize for our chairman, who was called away. He turned the hearing over to the staff, and we promise not to take advantage of that situation.

However, we would like to know if any members of the panel would like to comment on any of the other testimony that they have heard.

Mr. BRESNAN. I would like to comment on some of the remarks made by the gentleman from Central Telephone Co. I have been in the cable business a little over 20 years. Virtually all of my entire career. And I have got the bloody scars to prove that the telephone company is not quite as benevolent and benign as they would lead us to believe.

As a matter of fact, I can relate to you an experience I had with the Central Telephone Co. We applied for a CATV certificate of public convenience and necessity in Las Vegas, Nev. In Nevada, cable TV is regarded as a utility. This was in 1966. And the telephone company, Centel, which services that area, petitioned to intervene, showed up at the hearing with an entourage of people that outnumbered the rest of the parties in aggregate, and told the Public Service Commission of Nevada, with an air of arrogance that only the telephone company has, that the Public Service Commission was wasting its time by conducting these hearings, because regardless of who the Public Service Commission might pick to service the city of Las Vegas, it was irrelevant, because Central Telephone was not going to grant a pole attachment agreement to anyone, and that they, Centel, were going to build the cable system themselves.

The Public Service Commission determined that maybe it was wasting its time, but it was going to go ahead with the hearings in any event. At this point, the Public Service Commission told us that in order to perfect our application, we should submit to the Commission a map showing the proposed routing of our system. In order to do that, we needed the pole line maps from the telephone company. We went to Centel and asked for such maps, and Centel refused to give them to us. Then the Public Service Commission ordered Centel to give us the maps, and they did.

The hearings were not resumed for over a year. Then—I believe it was in 1967—Centel had had a slight change of heart and appeared at the hearing, not as an intervenor but as an applicant. It wanted to build a cable system in the market.

And for some reason, I don't know whether it was coincidental or not, after the hearings were concluded, the Public Service Commission did not grant a certificate until after the FCC had acted on its prohibition against cross-ownership by a telephone company of a system.

Central Telephone, of course, did not receive the certificate. We did. And we went to Centel for a pole attachment agreement. The proposed pole attachment agreement we were given by Central Telephone Co. restricted us to the carriage of just off-the-air TV signals. We could not carry FM radio signals, any types of data or pay television.

And if I remember correctly, the rate was around \$12 a year per pole. This was when pole attachment rates were typically \$2, \$3, or maybe \$4.

Senator WARNER. Keep your voice up so that the reporter can hear you.

Mr. BRESNAN. This is a history of one example, one confrontation that I have had with Central Telephone Co. So when he says that our fears of the telephone companies' steamrolling are unjustified, I just cannot buy it.

Senator WARNER. As the law now provides, you have equal time.

Mr. ARLOW. Of course, I cannot claim any first-hand knowledge of this incident. But I am impressed by the fact that the description which you gave, while fairly short in facts regarding the particular circumstances and what the regulatory framework was at the time, was fairly vivid with respect to its effects—how the people walked in with a great air of arrogance and an entourage.

Nevertheless, I can only speak to what I know, and my acquaintance has been with the company's current policy and the area in which we have gotten into—CATV. And our view at present on CATV is that it is a good, growing business, and there are a tremendous number of services which can be offered over CATV.

There is an awful lot of America out there that is not Centel territory, and it is that territory that we are looking to, not just our own telephone territories. And that is why we need a fairly evenhanded approach.

As I say, I do not have any special background with respect to the particular incident, about what occurred in Las Vegas, I guess it was 13 years ago. However, if the committee would like, we can file perhaps an attachment to the general written comments which will have an explanation, even perhaps the decision from the Nevada Public Service Commission, if they have this material, in detail, and describe the reasons for granting the certificate and the actions of the parties at the time.

Senator WARNER. That will be entirely within your discretion.

Mr. ARLOW. Thank you, Senator.

Mr. BRESNAN. We could submit volumes that would fill this room of similar situations.

Senator WARNER. Let us try to avoid that.

Mr. BRESNAN. I would like to clarify the point that the cable television industry does not have a problem with the telephone company providing cable service in an area outside of its telephone service area. Our concern is simply where they are providing telephone service and could use their monopoly power, and could use the revenues from the monopoly service to cross-subsidize competitive services.

Where he refers to providing service outside the telephone service area, fine. We welcome his competition.

Senator WARNER. You are only concerned with the cross-ownership, and the telephone companies would be free outside of their own service area to proceed as any other communications company, not a regular carrier?

Mr. BRESNAN. That is right.

Senator WARNER. Anything further from the panel?

[No response.]

Senator WARNER. This concludes the panel discussion. We are recessed until Monday morning at 10 o'clock. Thank you very much.

[Whereupon, at 3:10 p.m., the hearing was recessed, to reconvene at 10 a.m. on Monday, April 30, 1979.]

AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

MONDAY, APRIL 30, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 10:04 a.m. in room 235, Russell Senate Office Building, Hon. Ernest F. Hollings (chairman of the subcommittee) presiding.

Senator HOLLINGS. Good morning.

The hearings will resume with our access charge panel. We are very pleased to have an outstanding group: Mr. McGowan, MCI Communications Corp.; Warren French, Organization for the Protection and Advancement of Small Telephone Companies; Roy Bahnson, General Telephone & Electronics Corp.; and Charles R. Jones, A.T. & T., Separations and Division of Revenues; and Dale Hatfield, National Telecommunications and Information Administration.

STATEMENTS OF WILLIAM G. MCGOWAN, MCI COMMUNICATIONS CORP.; WARREN FRENCH, ORGANIZATION FOR THE PROTECTION AND ADVANCEMENT OF SMALL TELEPHONE COMPANIES; ROY BAHNSON, GENERAL TELEPHONE & ELECTRONICS CORP.; CHARLES R. JONES A.T. & T., SEPARATIONS AND REVENUES; AND DALE HATFIELD, NATIONAL TELECOMMUNICATIONS AND INFORMATION ADMINISTRATION

Senator HOLLINGS. I noticed this morning we started a hearing at 7:30, or earlier, because they had the national broadcasters and the cable TV, Bob Schmidt, and the broadcasters were saying that with the cable TV taking the signals off, they weren't paid anything for it, and they were eroding the economic pace and reducing programs.

And immediately Schmidt came back and said, "You are not paying anything."

Let's see what you folks think.

Mr. McGowan, can you start us, first?

Mr. MCGOWAN. Mr. Chairman, members of the subcommittee, good morning.

S. 611 envisions an access charge on two levels. S. 622 envisions much the same procedure, although it combines identifiable costs and subsidy elements to maintain reasonable exchange rates within a single access charge.

Both of these provisions have much to recommend them. First, there is appropriate Federal jurisdiction over the terms, conditions,

technical characteristics, and rates for access. Access is no more than a component in an intercity transmission link, and thus Federal regulation is not only more logical but also vitally necessary if the deregulatory objectives of both bills are to be met.

Second, the elimination of the industry-run separations and settlements process is long overdue, principally because, like charity, it has covered a multitude of sins perpetrated by the industry for the sole benefit of the industry.

Separations has been the device that A.T. & T. has used to hold in thrall the 1,550 so-called independent telephone carriers. This domination was easily achievable, since A.T. & T. controlled the mechanism for dispensing toll revenues, and determined the amount each independent received, proportional to A.T. & T.'s need for the non-Bell carriers support in causes often far removed from maintaining universal telephone service at affordable rates.

A.T. & T. Chairman Brown has referred to the separations process as a black art. He's right. You could see that black magic at work when your endorsement was solicited for the Bell bill in 1976 principally by representatives of the non-Bell carriers.

Let me assure you that A.T. & T. had bought that support, first by intimidation, and second by the separations process.

Eliminating separations and settlements is a necessary precondition to achieving a meaningful accounting system for A.T. & T. and the local exchange industry. Separations encourages the development of inallocable costs, because that is the element which is susceptible to arbitrary—and thus politically very useful—decision-making.

I assure you that once separations is no more, you will see a very rapid acceleration in the industry's accounting abilities.

I do not mean to suggest by this that any such accounting system developed by A.T. & T. will not be preeminently self-serving. It will be. And therefore don't count on it readily to highlight cross-subsidy, predatory pricing, or other anticompetitive behavior. And don't expect it to substitute for identifying subsidy areas, as Mr. Brown has suggested it could. It won't work that way.

But be that as it may, it will be an improvement over the complete void that exists today in determining facilities and service costs. For the industry will finally have an audit trail, instead of a garbage in-garbage out process for maintaining data to justify predetermined conclusions.

Third, the access provisions in S. 611 and S. 622 will finally give the local exchange industry the incentive to efficiency, performance, and technological adaptiveness that separations and Settlements have, in effect, denied them.

The local exchange industry is put on notice that it's going off welfare, and is going to have to start earning its keep. The cost-based access provision is a powerful incentive to any telephone executive to start running the company like the business it is.

Again, let me assure you that successfully weaning the local exchange industry from A.T. & T.'s dole will promote a resurgence of that industry from the stagnant backwater in which it has steeped for 50 years into a vibrant, turning tide that will significantly contribute to achieving an urban-rural parity in the diversity, availability, and usefulness of telecommunications services.

Why is all this so important to an interexchange carrier like MCI? Simply because the local exchange carrier is the critical link in our provision of our intercity services.

At the risk of rubbing salt into a wound that rankles the chairman, may I use an airline analogy to stress my point?

MCI is like a trunk air carrier flying among cities throughout the United States. Our passengers board and deplane at the airports, the MCI terminals, in the communities we serve.

But if passengers cannot readily get out to or in from our airports, then our planes are of little use. And it is the local exchange carriers who deliver to and pick up from our terminals.

But just as the local industry is the critical link to our provision of service, it is also today the weakest link. This is so for one reason only, and that is A.T. & T.'s current ability completely to dominate every single local exchange carrier in the United States.

That dominance is achieved either through outright ownership, as is the case with the 23 giant Bell operating companies who own 80 percent of the country's telephones, or through the economic dominance which separations permits A.T. & T. to exercise over the non-Bell exchanges.

A.T. & T. has used this unchecked control to discriminate between the MCI's of the world, on the one hand, and their competitor, A.T. & T.'s own Long Lines Department.

Let me be specific: Any local exchange carrier will give A.T. & T. Long Lines broadband interface—or four-wire central trunk connection. No local exchange carrier will give that to MCI.

Any local exchange carrier will give A.T. & T. Long Lines answer supervision, nondiscriminatory testing, maintenance, and other support. No local exchange carrier will give that to MCI.

Why? Because A.T. & T. had told them not to.

What A.T. & T. has told them to do—and therefore what indeed they do—is to give A.T. & T. the names and revenue figures of our customers, information one would certainly consider proprietary, especially with today's emphasis on protecting the right to privacy.

Just one more example. A.T. & T. has insisted that any relationship we have with the local telephone carriers be arranged through A.T. & T. This can and often does reach ludicrous proportions.

A.T. & T. recently filed on behalf of the operating companies a tariff setting forth the rates that the operating companies would charge us for various forms of interconnection. When we sought clarification of certain of the pricing elements at issue, we were quickly warned by A.T. & T. not to discuss this matter with the local carriers involved. "We haven't told the operating companies what their rates are going to be yet," the A.T. & T. representative said.

So there we are, with A.T. & T. exercising total control over the terms, conditions, technical characteristics, and rates for access, and with A.T. & T. exercising that total control to benefit Long Lines and disadvantage the specialized carriers.

The impact of this discrimination, of course, is felt not only by us, but by our customers, since we must build around the access barriers that A.T. & T. has deliberately erected against us. This necessitates a willingness on the part of our customers to accept occasional inconveniences in order to enjoy MCI's services.

Let me stress that this discrimination persists in a competitive environment which is supposed to be full and fair because of regulatory decision and judicial ruling, as well as marketplace demand and technological imperative.

As a result of MCI's decade of experience in dealing with the local telephone industry through the filters of A.T. & T., I am personally convinced, Mr. Chairman, that separate subsidiaries will not do the job that S. 611, specifically, and S. 622, by implication, intend in insuring equitable and nondiscriminator access.

Common ownership of entities operating both in the intraexchange and interexchange markets should, I believe, be forbidden. Only when A.T. & T. is deprived of the incentive to abuse its control of the local exchange carriers will those carriers begin to operate as the vital service entities that they should and can be.

I suggest that A.T. & T. be given a choice, Mr. Chairman; either A.T. & T. retains control of Long Lines' interexchange operations or it retains control of the Bell operating companies, but not both. Whichever A.T. & T. elects to spin off, ownership interest could be distributed to A.T. & T.'s stockholders proportional to their holdings in the parent company.

There is no doubt that this will pose a hard choice for A.T. & T., but it is a choice that A.T. & T.'s misconduct justifies its having to make.

Beyond consideration of justice, I believe the point that you made earlier in these hearings about A.T. & T.'s present structure with 26 separate subsidiaries is very well taken. All the problems that Motorola, or Litton, or MCI, or Southern Pacific, or ITT, or everyone else has experienced with A.T. & T. have come from dealing with A.T. & T. as it is presently structured. No adequate remedy can realistically be expected to flow through that current structure.

This is not to suggest that the subsidiary concept would not have its uses.

It is clear that in drafting S. 611 and S. 622, and even H.R. 3333, their authors have come to grips with the implications of A.T. & T.'s current structure and the consequences of what A.T. & T. Chairman Brown calls alternative futures.

In rejecting structural modification of A.T. & T., the bills' formulators may well have concluded that such a remedy is legislatively infeasible. And perhaps it is today.

Perhaps what we, the wronged competitors, must do is press our case in other forums so effectively that what is today perceived as a legislative impracticality will tomorrow become a political inevitability.

I have every confidence that this can be done, for I am convinced that at least three—perhaps more—of the scores of pending antitrust actions against A.T. & T. will go to trial during 1979 and 1980—including MCI's own and the Department of Justice's.

This litigation will demonstrate conclusively to the courts and the Congress, if it is interested, the crying need for fundamental industry reorganization to preclude continued arrogant abuse by A.T. & T. of basic antitrust principles, principles that it has so flagrantly flouted throughout its corporate life—for the courts base

their judgments upon proven misconduct; the purpose of their decrees is to compel compliance with the law.

And thus I expect the courts to enforce laws that Congress has already passed, namely the Sherman and Clayton Acts, and that from such enforcement, we will all confront a revised industry structure which will readjust the ownership and operating relationships of the business in a major, and altogether beneficial, way.

Until that time comes, MCI will continue to press for the full range of access arrangements from the local telephone industry at fair, nondiscriminatory, and cost-based prices, using every forum it can command so that when this industry is indeed finally deregulated, the competitive mechanisms for delivering innovation, diversity, economy, and value to the U.S. telecommunications using community will be so deeply ingrained and thickly rooted that not even A.T. & T. will be able to eradicate them.

Mr. Chairman, MCI would like to offer for the record of these proceedings a detailed section-by-section analysis of S. 611 and S. 622 which will describe our position on other issues addressed by the bills. If this is agreeable, we will have this material to you within a week.

Senator HOLLINGS. We would be glad to have that and leave it open to questions.

[The statement follows:]

STATEMENT OF WILLIAM G. MCGOWAN, CHAIRMAN OF THE BOARD AND CHIEF
EXECUTIVE OFFICER, MCI COMMUNICATIONS CORP.

Mr. Chairman, members of the subcommittee, good morning.

S. 611 envisions an access charge on two levels. The first, based on the identifiable costs for the interconnection facilities provided by the local exchange carrier is payable directly to that local carrier by each interexchange carrier.

The second, based on the local exchange carrier's common costs and a subsidy element, is payment to the Basic Exchange Maintenance Program administered by a Federal/State Joint Board. This second level charge remains at a fixed amount, and thus will gradually decline in real terms over time.

S. 622 envisions much the same procedure, although it combines identifiable cost and subsidy elements to maintain reasonable exchange rates in a single access charge which will be placed in a fund administered by the participating carriers, with oversight by the Federal Communications Commission. This single access charge terminates after six years, at which time inter-exchange carriers begin to pay for local interconnection under tariffs filed with the FCC which will be based entirely on the actual costs of the local exchange facilities used to achieve interconnection.

Both of these provisions have much to recommend them. First there is appropriate Federal jurisdiction over the terms, conditions, technical characteristics, and rates for access. Access is no more than a component in an intercity transmission link, and thus Federal regulation is not only more logical, but also vitally necessary if the deregulatory objectives of both bills are to be met.

Second, the elimination of the industry-run Separations and Settlements process is long overdue, principally because, like charity, it has covered a multitude of sins perpetrated by the industry for the sole benefit of the industry. Separations has been the device that A.T. & T. has used to hold in thrall the 1,550 so-called "independent telephone carriers. This domination was easily achievable, since A.T. & T. controlled the mechanism for dispensing toll revenues, and determined the amount each independent received, proportional to A.T. & T.'s need for the non-Bell carriers' support in causes often far removed from maintaining universal telephone service at affordable rates.

A.T. & T. Chairman Brown has referred to the Separations process as a "black art". He's right. You could see that black magic at work when your endorsement was solicited for the Bell bill in 1976 principally by representatives of the non-Bell carriers. Let me assure you that A.T. & T. had bought that support first by intimidation, and second by the Separations process.

Eliminating Separations is a necessary precondition to achieving a meaningful accounting system for A.T. & T. and the local exchange industry. Separations is designed to encourage the development of inallocable costs, because that is the element which is susceptible to arbitrary—and thus politically very useful—decisionmaking. I assure you that once Separations is no more, you will see a very rapid acceleration in the industry's accounting abilities.

I do not mean to suggest by this that any such accounting system developed by A.T. & T. will not be preeminently self-serving. It will be. And therefore don't count on it readily to highlight cross subsidy, predatory pricing or other anticompetitive behavior.

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Again, let me assure you that successfully weaning the local exchange industry from A.T. & T.'s dole will promote a resurgence of that industry from the stagnant backwater in which it has steeped for 50 years into a vibrant, turning tide that will significantly contribute to achieving an urban-rural parity in the diversity, availability and usefulness of tele-communications services.

Why is all this so important to an interexchange carrier like MCI? Simply because the local exchange carrier is the critical link in our provision of our intercity services.

At the risk of rubbing salt into a wound that rankles the chairman, may I use an airline analogy to stress my point. MCI is like a trunk air carrier flying among cities throughout the United States. Our passengers board and deplane at the airports—the MCI terminals—in the communities we serve. But, if passengers cannot readily get out to or in from our airports, then our planes are of little use. And it is the local exchange carriers who deliver to and pick up from our terminals.

But just as the local industry is the critical link in our provision of service, it is also today the weakest link. This is so for one reason only, and that is A.T. & T.'s current ability completely to dominate every single local exchange carrier in the United States.

That dominance is achieved either through outright ownership, as is the case with the 23 giant Bell operating companies who own 80% of the country's local exchanges, or through the economic dominance which Separations permits A.T. & T. to exercise over the non-Bell exchanges.

A.T. & T. has used this unchecked control to discriminate between the MCIs of the world on the one hand, and their competitor, A.T. & T.'s own Long Lines Department. Let me be specific:

Any local exchange carrier will give A.T. & T. Long Lines broadband interface. No local exchange carrier will give that to MCI.

Any local exchange carrier will give A.T. & T. Long Lines answer supervision, non-discriminatory testing, maintenance and other support. No local exchange carrier will give that to MCI.

Why? Because A.T. & T. has told them not to.

Why A.T. & T. has told them to do, and therefore what indeed they do, is to give A.T. & T. the names and revenue figures of our customers, information one would certainly consider proprietary, especially with today's emphasis on protecting the right to privacy.

As an aside that may be of interest to you, I recently participated in a legislative panel of the Communications Workers of America. When their president listed certain of the union's political priorities, the right to privacy got the most sustained applause. I must remember to urge the CWA to look into their employers' practices when it comes to violations of this right committed in the name of competitive expediency.

Just one more example of A.T. & T.'s total control. A.T. & T. always insists that any relationship we have with a local telephone carrier be arranged by it. This can—and often does—reach ludicrous proportions. A.T. & T. recently filed on behalf of the operating companies a tariff setting forth the rates that the operating companies would charge us for various forms of interconnection. When we sought clarification of certain of the pricing elements at issue, we were quickly warned by A.T. & T. not to discuss this matter with the local carriers involved. "We haven't

told the operating companies what their rates are going to be yet", the A.T. & T. representative said.

So there we are, with A.T. & T. exercising total control over the terms, conditions, technical characteristics, and rates for access, and with A.T. & T. exercising that total control to benefit Long Lines and disadvantage the specialized carriers.

The impact of this discrimination, of course, is felt not only by us, but by our customers, since we must build around the access barriers that A.T. & T. has deliberately erected against us. This necessitates a willingness on the part of our customers to accept occasional inconveniences in order to enjoy MCI's services.

Let me stress that this discrimination persists in a competitive environment which is supposed to be full and fair because of regulatory decision and judicial ruling, as well as marketplace demand and technological imperative.

As a result of MCI's decade of experience in dealing with the local telephone industry through the filters of A.T. & T., I am personally convinced, Mr. Chairman, that separate subsidiaries will not do the job that S. 611—specifically—and S. 622—by implication—intend in ensuring equitable and non-discriminatory access. Common ownership of entities operating both in the intraexchange and interexchange markets should, I believe, be forbidden. Only when A.T. & T. is deprived of the incentive to abuse its control of the local exchange carriers will those carriers begin to operate as the vital service entities that they should and can be.

I suggest that A.T. & T. be given a choice, Mr. Chairman; either A.T. & T. retains control of Long Lines, or it retains control of the Bell operating companies. But not both. Whichever A.T. & T. elects to spin off, ownership interest could be distributed to A.T. & T.'s stockholders proportional to their holdings in the parent company.

There is no doubt that this will pose a hard choice for A.T. & T.; but it is a choice that A.T. & T. misconduct justifies its having to make.

Beyond consideration of justice, I believe the point that you made earlier in these hearings about A.T. & T. present structure with 26 separate subsidiaries is very well taken, Mr. Chairman. All the problems that Motorola, or Litton, or MCI, or Southern Pacific, or ITT—or everyone else has experienced with A.T. & T. have come from dealing with A.T. & T. as it is presently structured. No adequate remedy can realistically be expected to flow through that current structure.

It is clear that in drafting S. 611, S. 622 and even H.R. 3333, their authors have come to grips with the implications of A.T. & T. current structure, and the consequences of what A.T. & T. Chairman Brown calls "alternative futures".

In rejecting structural modification of A.T. & T., the bills' formulators may well have conclude that such a remedy is legislatively infeasible. And perhaps it is.

Perhaps what we, the wronged competitors, must do is press our case in other forums so effectively that what is today perceived as a legislative impracticality will tomorrow become a political inevitability.

I have every confidence that this can be done, for I am convinced that at least three—perhaps more—of the scores of pending antitrust actions against A.T. & T. will go to trial during 1979 and 1980—including MCI's own and the Department of Justice's.

This litigation will demonstrate conclusively to the courts and the Congress—if it is interested—the crying need for fundamental industry reorganization to preclude continued arrogant abuse by A.T. & T. of basic antitrust principles—principles that it has so flagrantly flouted throughout its corporate life. For the courts base their judgments upon proven misconduct; the purpose of their decrees is to compel compliance with the law.

And thus I expect the courts to enforce laws that Congress has already passed, namely the Sherman and Clayton Acts, and that from such enforcement, we will all confront a revised industry structure which will readjust the ownership and operating relationships of the business in a major—and altogether beneficial—way. Until that time comes, MCI will continue to press for the full range of access arrangements from the local telephone industry at fair, non-discriminatory, and cost-based prices, using every forum it can command so that when this industry is indeed finally deregulated, the competitive mechanisms for delivering innovation, diversity, economy and value to the U.S. telecommunications using community will be so deeply ingrained and thickly rooted that not even A.T. & T. will be able to eradicate them.

Mr. Chairman, MCI would like to offer for the record of these proceedings a detailed section-by-section analysis of S. 611 and S. 622 which will describe our position on other issues addressed by the bills, specifically the Spectrum Fee and the entire concept of a subsidy or contribution above cost. If this is agreeable to you, we could have this material to you within the week.

[The following information was subsequently received for the record:]

MCI COMMUNICATIONS CORP.,
Washington, D.C., June 1, 1979.

Hon. HOWARD CANNON,
Senate Communications Subcommittee,
U.S. Senate, Washington, D.C.

DEAR SENATOR CANNON: MCI Communications Corporation wishes to supplement the testimony of William G. McGowan, its Chairman and Chief Executive Officer, given before the Subcommittee on April 30 and May 2, 1979. I am therefore enclosing copies of section-by-section analyses of both S. 611 and S. 622 which we have prepared. These indicate with respect to those portions of the bills which affect MCI and which deal with matters within its experience—the sections which we support as written and those which we believe should be revised in order to achieve the stated objectives of the legislation, with which MCI wholeheartedly agrees.

MCI greatly appreciates your interest in these important proposals. I hope you will find the enclosed analyses useful in your deliberations with respect to S. 611 and S. 622. If you or the members of your staff have any question about the matters covered therein, I would be happy to discuss them at any time.

Very truly yours,

KENNETH A. COX.

Enclosures.

COMMENTS OF MCI COMMUNICATIONS CORP. ON S. 611, THE COMMUNICATIONS ACT
AMENDMENTS OF 1979

MCI Communications Corporation (MCI) believes the proposed Communications Act Amendments of 1979 (S. 611) represents a highly commendable effort to update the Communications Act of 1934, while leaving the basic framework of the existing law undisturbed. MCI believes that is a desirable and practical approach because it feels that the problems which have arisen in recent years do not flow from the structure or basic authority of the Federal Communications Commission (FCC), but rather, from the conduct and structure of the Bell System, coupled with technological change. Those matters can be corrected most simply and effectively by amending just those portions of the present Act where updating or clarification is required.

MCI appreciates the concentrated attention the drafters of S. 611 have given to common carrier regulation, and it is to that part of the bill, and to some of the general provisions of Titles I and V, that these comments will be directed.

MCI applauds the general thrust of the bill because of its emphasis and reliance upon competition in the provision of telecommunications as the best means of promoting the public's interest in efficient, innovative, low cost telecommunications service.

While MCI will note its support for those provisions of S. 611 of which it approves, it believes it can best assist the Subcommittee by concentrating its attention on those sections which MCI believes pose problems and should be modified.

Section 102 of S. 611 amends Section 1 (redesignated *Section 101*) of the 1934 Act by broadening the purposes of the Act. This is desirable and constructive and the new language should be approved. Similarly, Section 103 amends Section 2 (redesignated *Section 102*) of the present Act to broaden its application to include all interexchange telecommunications, all commerce in information software and services, etc. The expansion of the FCC's jurisdiction to cover the new areas referred to is highly desirable. And Section 104 amends present Section 3 (redesignated *Section 103*) to add new definitions and to refine some of the present ones. All the proposed changes seem logical and desirable. However, some language should be added somewhere in the bill to make it clear that the Commission's newly granted jurisdiction over all commerce in telecommunications equipment and services, etc., is to be exercised only in accordance with specific directives contained in the Act.

Section 106 of S. 611 adds a new *Section 106* to the law to provide for new public resource use fees. Insofar as these are to be applied to telecommunications carriers, MCI believes that the fees should be limited to the FCC's cost of handling a carrier's radio applications and tariffs (if it is required to file the latter). Such charges, which become a cost of doing business, would be passed on to the carrier's customers. They should therefore be restricted to permitting the Commission to recoup its costs in dealing with a given carrier, so that the burden on the public will not exceed the benefit the public receives by virtue of the agency's activities in regulating the carrier in question. In any event, there is no practical way to determine the "fair market value of the benefit conferred" upon a carrier by a license to use a part of

the frequency spectrum as specified in Section 106(b)(1)(B)(v). There has never been a market mechanism with respect to the spectrum used by carriers. The suggestion, in Section 106(b)(2), that the value of a license may be determined by such methods as sealed bidding and oral auctions is a dangerous one. A carrier with substantial resources could outbid all others for certain critical frequencies, such as those required to reach the centers of major metropolitan areas. At the very least, such a dominant carrier would be able to bid up the charges unreasonably and thereby impose additional and unnecessary cost burdens on its competitors and their customers. Either course would clearly be contrary to the public interest and would not achieve the statutory goal of encouraging the efficient use of the spectrum. But most importantly, such practices would place new suppliers of service at a distinct competitive disadvantage with respect to the established dominant carrier and thereby impede realization of the pro-competitive objectives of the bill.

Section 201 consists of new congressional findings and declarations. It stresses the present benefits of selective deregulation which has led to competition in the supply of telecommunications and calls for further progress in this direction. MCI applauds these statements of congressional policy. It is not clear, however, where the material in this section is to be incorporated into the Communications Act.

Section 203 amends Section 201 of the 1934 Act to set forth an excellent statement of policy, namely, that telecommunications and information services and equipment shall be provided under conditions of full and fair competition to the maximum extent feasible and that, presumptively, absent a showing to the contrary, there are no basic technological, operational, or economic factors which would preclude the provision of any interexchange telecommunications service on a competitive basis. On the other hand, it recognizes that some telecommunications service will be provided on a regulated, noncompetitive basis and provides that consumers of such service shall not be required, through cross-subsidization, to bear the costs of the carrier's competitive ventures. All of this is soundly based on recent experience and represents a proper policy for the future.

Section 204 amends Section 202 of the 1934 Act to direct the FCC to exercise only so much of its powers under Title II as are essential to the purposes of the Act. This again is good policy since it recognizes that, while there will be a need for continued regulation as competition is being phased in, the need for such regulation should diminish as competition takes hold.

Sections 205 and 206 amend Sections 203 and 204 of the 1934 Act. MCI believes that the order of new Sections 203 and 204 should be reversed. It would appear more logical to have the provisions as to classification of carriers precede the sections which employ such classifications. However, the following comments are addressed to these sections as they are now designated.

Section 203(a) states that the provision of telecommunications equipment and information services and software shall not be deemed to be a telecommunications service and that such activities shall be subject to regulation, whether at the Federal or State level, only as provided in Section 203. MCI believes that the word "telecommunications" (at page 22, line 7) is misleading and should be deleted.

New Section 203(b) provides that all Category II carriers and all carriers providing exchange telecommunications service as to which they are not subject to effective competition may only manufacture or market telecommunications or electronic equipment or information service or software through an affiliated but fully separated entity, unless, after hearing, the Commission determines that competition and the public interest can be protected through less stringent measures provided in Section 205(b). State Commissions are authorized to permit small exchange carriers to market such equipment or service without complying with this section where it is determined that the requirements would be unreasonable because of the size of the exchange carrier. These provisions properly require full separation [as defined in Section 103(11)] between the telecommunications service operations of carriers possessing monopoly power and their offering of terminal devices or computer or other information service or equipment, thus allowing them to compete in the latter markets while at the same time minimizing the dangers of cross-subsidy. The State Commissions' power to exempt small exchange carriers provides a sensible way of avoiding unduly burdensome applications of the basic policy.

New Section 203(c) provides that a Category II carrier may offer telecommunications equipment as an integral part of a telecommunications service only to the extent, and in the manner, authorized by the Commission under Section 205(b). This is not as clear as it might be, but apparently creates an exception of some kind to Section 203(b)(1) as to equipment offered as an integral part of a telecommunications service—as long as it is done under conditions set by the Commission.

New Sections 203(d), (e), and (f) provide for the continuance of the Commission's terminal equipment registration program. Giving explicit statutory grounding for

this very useful program is desirable—as is the language tying this to fostering competition in equipment supply. These provisions also bar the states from imposing special requirements upon the manufacture or marketing of such equipment and prevent the Commission from imposing its control over non-carrier suppliers of telecommunications or electronic equipment or information service or software, except for the standards authorized in Section 203(d). Perhaps it would be wise to add language to Section 203(d)(1) to make clear that it does not apply to equipment which is not to be connected directly to a telecommunications network.

New Section 203(g) provides for the classification of those entities which provide joint or integrated telecommunications service (i.e., an information or other non-telecommunications service of which a telecommunications service is a separable or integral part). Where the interexchange telecommunications portion of the service is accomplished through the lease and resale of facilities or services provided by a fully separated or non-affiliated carrier on a nondiscriminatory basis, then the entity providing the joint or integrated telecommunications and information service will be deemed a Category I carrier. But if the interexchange portion is accomplished in substantial part by means of facilities owned by or under the control of the entity providing the integrated service, or of an affiliate, the Commission will classify that entity depending upon the degree to which it is subject to effective competition in the provision of such joint or integrated telecommunications and information service. This seems a possible approach to the problem of dealing with the combination of communications and data processing services, as long as the requirements of section 203(b) apply if the entity is classified as a Category I carrier. However, MCI finds this section less than crystal clear and an effort should be made to clarify it.

New Section 204 provides for the classification of carriers, for regulatory purposes, as being either Category I or Category II carriers. Category I will include carriers which provide only services subject to competition and which are not affiliated with a Category II carrier. On the other hand, any carrier which provides any telecommunications service, either nationally or regionally, which is not subject to effective competition is to be classified as a Category II carrier. The Section further provides that the Commission shall designate as a Category II carrier any carrier providing a telecommunications service both so essential to the public interest and so unlikely to be generally available at reasonable rates under competitive conditions that competition in the provision of such service would not be consistent with the purposes of the Act. There appears to be no need for this latter provision since it seems clear that such a service would not be subject to effective competition and any entity providing it would therefore already be classifiable as a Category II carrier.

The Section also contains specific direction for (a) the establishment of classes and subclasses of telecommunications services based on their functional capability for the user and the degree of substitutability among services, (b) the public identification of all Category II carriers, and (c) reclassification of carriers and the classification of new carriers. In determining whether a carrier's offering of a given service is subject to effective competition, the Commission is to consider, among other things, such carrier's share of total revenues received by all carriers providing similar services within the same market. Absent a showing to the contrary, it is to be presumed that a carrier is subject to effective competition if its market share does not exceed one-third. MCI believes that the classification of carriers as proposed in Section 204, and their regulation in accordance with such classification, makes good sense and will facilitate deregulation of fully competitive carriers while continuing needed regulation for Category II carriers.

Section 207 amends Section 205 of the 1934 Act by greatly expanding the Commission's prescription authority and giving the agency the right to prescribe different requirements for different categories of carriers and different classes of service. The Commission may not, however, impose requirements on Category I carriers other than those specifically authorized in Title II. Thus, the Commission is wisely given broad powers as to Category II carriers so as to enable it to protect the competitiveness of those markets in which competition exists, or is capable of developing, by preventing cross-subsidization and other anticompetitive practices. The Commission is authorized to prescribe separation, short of that provided for in Section 203(b), between a carrier's (or affiliate's) telecommunications and non-telecommunications activities, and between those telecommunications services in which it is subject to effective competition and those in which it is not. The Commission is authorized to prescribe joint operations among carriers. This apparently means the establishment of through routes, but the term should be specifically defined. It is a bit incongruous to find, in the midst of all these powers to curb monopoly power, a grant to the Commission of authority to "award an exclusive franchise to one or more carriers,

or impose such other requirements as the Commission deems necessary to ensure the provision of an essential public service". Does this mean that the Commission might conclude that MTS is an essential public service whose provision can only be ensured by granting AT&T an exclusive franchise? Such exclusive franchises are not granted locally on the basis of limited operating territories, but this provision might be claimed to authorize a nationwide de jure monopoly. What procedures would the Commission be required to employ before making such an unprecedented award? In fact, it is not clear what procedures would be required with respect to all of the various steps the Commission is authorized to take by Section 205. MCI believes that some additional language is needed to make it clear that the agency must comply with the Administrative Procedure Act and the requirements of due process.

While classification as a category II carrier does not automatically bar a carrier from providing any telecommunications service, the Commission can order a Category II carrier to stop providing a service—or not to begin—where its provision of the service in question would be inconsistent with the purposes of the Act. After 180 days from enactment of S. 611, this Section bars a Category II carrier which provides exchange service for which it is not subject to effective competition from providing any interexchange service, other than exchange network access service, except through a fully separate carrier. Similarly, after 180 days, no Category II carrier which provides any interexchange public message telephone service, for which it is not subject to effective competition, may provide any other interexchange service, except that such a carrier can provide, through nondiscriminatory lease or tariff arrangement, interexchange facilities or services to fully separated or non-affiliated carriers, which can use them in providing such other interexchange services. Again, after 180 days, a carrier which provides any interexchange service, other than interexchange access service, will be barred from providing any exchange service for which it is not subject to effective competition except through a fully separated carrier. The Commission is empowered, however, to waive this last bar and require less than full separation for small carriers operating solely within a single state. The Commission needs these varied and flexible powers if it is to promote competition and, at the same time, reduce detailed regulation of carriers. The legislation seeks to avoid regulation as much as possible by modifying the corporate structure of carriers to reduce incentives for anticompetitive conduct—or to make the detection of such conduct easier. These requirements of Section 205, which require separation between certain telecommunications services, supplement those in Section 203, which require separation between carriers and the manufacturers and marketers of equipment or the providers of information service or software. These requirements, although not as effective as would be complete divestiture between monopoly and competitive operations, would at least help identify possible cross-subsidization.

Section 209 of S. 611 adds a new *Section 207* which requires every carrier providing an exchange, interexchange, or international telecommunications service for which it is not subject to competition to establish physical interconnections with any other carrier upon request, including the establishment of joint through routes under Section 205(b). If the carriers involved cannot reach agreement concerning such interconnection, the Commission, after hearing, may determine a just and reasonable arrangement—and pending that determination, the agency can prescribe an interim arrangement or can offer its assistance in reaching a publicly negotiated arrangement between the parties. In view of the difficulties the new competitive carriers have had in getting interconnections, this is a critically important section. The more precise language of new Section 207 is a great improvement over the corresponding provision in the present Act. However, the section should be strengthened still further by specifying that such interconnections are to be provided on non-discriminatory terms and conditions (compare Section 251(a)). It is indeed vital that the legislation continue the authority of the FCC to fix just and reasonable charges for the local exchange interconnections the new interexchange carriers need. The contrary provisions, contained in the proposed legislation pending before the House, would seriously imperil the development of competition.

Section 210 of S. 611 redesignates Section 208 of the 1934 Act as Section 225(a) and then adds a new *Section 208* to the Act. This Section provides for deregulation of the charges and practices of Category I carriers by barring the Commission from imposing any requirements as to such matters. This is an important improvement since competition among Category I carriers will prevent them from overcharging or otherwise mistreating the public, thereby making regulation unnecessary. The Section goes on to provide that a Category II carrier must make available, upon reasonable request, any interexchange telecommunications service for which it is not subject to effective competition, and must establish just, reasonable, and nondis-

criminary tariffs for such service. This continued regulation of the monopoly services of Category II carriers is necessary, and S. 611 wisely continues the present Act's prohibitions against unreasonable discrimination, preference, or advantage.

Section 211 of S. 611 redesignates Section 209 of the 1934 Act as Section 225(b) and then adds a new *Section 209* to the Act. This section would authorize the Commission to require all carriers to file information as to their operations and to require Category II carriers to file tariffs. The new section would make these materials available to the public. It also bars a Category II carrier from operating in a manner which departs from its tariff. Two minor matters should be corrected. Section 209(a)(2) requires all carriers to "assure the continuing accuracy and completeness of information provided to the Commission" under Paragraph (a)(1) and requires this to be done "as promptly as possible and in any event within 30 days." This is vague and unnecessarily burdensome because much of the information carriers will be required to file will be changing from day to day but neither the public nor the Commission (except in special circumstances) needs to have the data constantly updated. This provision should either be deleted or should be restricted to major matters which have been presented to the Commission as the basis for action and which are still pending before it. Section 209(b) contains a reference to "connecting carriers", but the definition of that term in Section 3 of the 1934 Act has not been carried forward into Section 103 of S. 611 nor has a different meaning been established if one is intended. This omission should be corrected.

Section 212 of S. 611 amends *Section 210* of the 1934 Act to set forth new provisions as to tariffs. Subsection (a) deals with tariffs of a Category II carrier for services for which it is not subject to effective competition. It specifies that such a tariff shall not take effect until it has been either conditionally accepted or finally approved by the Commission, and requires the latter to make an initial decision—either accepting or rejecting the tariff or prescribing a different tariff—within 90 days of the filing of the tariff, except that it can request additional information and extend the period for another 90 days. During this period, the agency can assist public negotiation between the carrier proposing the tariff and interested parties opposing it. The Commission must give public notice when it accepts or rejects a proposed tariff, or when it prescribes a tariff. Either the carrier or any other interested party may request a hearing as to the proposed tariff, or one prescribed in its place. In that proceeding the burden of proof to show that the initially proposed tariff is just and reasonable is to be on the carrier. Pending hearing, any tariff conditionally accepted or prescribed by the FCC shall have effect, while any tariff rejected shall be of no effect, with the prior tariff for the same service remaining in effect. This is somewhat confusing. It is clear that if the Commission rejects the proposed tariff within 90 days, it never becomes effective, and the prior tariff, if there was one, remains in effect. MCI believes it should be specified that, if the preceding tariff or tariffs had also been found unlawful, the last uncontested tariff should be made effective again until it is superseded by a new and valid tariff. It is not clear what conditional acceptance of a tariff involves. Does it just mean that the Commission does not challenge it on its own motion, but that it remains subject to challenge at a later time? Or does it merely involve a decision to let the tariff go into effect pending a hearing as to its lawfulness? Presumably the Commission cannot "finally approve" a tariff without a hearing, if such approval is supposed to bar later challenge thereto. Similarly, while the Commission should be authorized to make an interim prescription of a tariff different from that filed, on the basis of the submissions of the various parties—this must be the kind of prescription referred to in Section 210(a) (2) and (4)—presumably it cannot make a long run prescription of a different tariff except on the basis of some kind of a hearing. MCI believes Section 210(a) should be substantially reworked.

The same is true of Section 210(b) which deals with the tariffs of Category II carriers offering interexchange services for which they do have effective competition. Here the tariff filed is allowed to go into effect in 30 days—although it appears that the Commission can extend that period somewhat if someone petitions for a hearing. Section 210(b)(1), in its proviso, refers to noncompliance with "any such conditions" without explaining what conditions it means. And Section 210(b)(2) requires the Commission to act upon a petition for hearing within 30 days of the carrier's reply thereto, which is much too short a period for proper Commission action. It also gives the agency power to suspend the proposed tariff pending a hearing, without specifying the duration of such a suspension. At the end of the hearing, the Commission is apparently authorized only to accept or reject the tariff as originally filed. At that point, however, the Commission will most likely want to prescribe a different tariff and should be authorized to do so. MCI understands the desire to allow a Category II carrier to respond promptly to initiatives taken by its competitors. But the time periods specified are much too short to allow response by

interested parties—or considered action by the Commission. Section 210(b) should be revised and clarified.

Section 213 of S. 611 amends *Section 211* of the 1934 Act with respect to the filing of inter-carrier and other contracts. The principal change is to require the filing of contracts only by Category II carriers. Certainly the latter's contracts will be of the greatest concern, but MCI believes it would be appropriate also to require Category I carriers to file their inter-carrier contracts with the Commission.

Section 214 of S. 611 amends *Section 212* of the 1934 Act, dealing with interlocking directorates, by making it Section 212(a) and inserting "Category II" before the word "carrier" wherever it appears. It also adds a new Subsection (b) which bars employees or directors of a Category II carrier, or its affiliates, from serving as officers or directors of a significant customer of the carrier, or of a supplier of goods or services to the carrier, or of a financial institution, or of a Category I carrier. This is a salutary restriction on inter-corporate relations which might be anticompetitive in effect. The same is true of the further provision that no employee or director of a substantial user of telephone service or equipment (except for an educational institution) shall be an officer or director of a Category II carrier. MCI supports these changes in the existing law.

Section 215 of S. 611 amends *Section 213* of the 1934 Act, which deals with valuation of carrier property. One principal change is to confine the Commission's power to valuation to Category II carriers, which is appropriate since the agency is not to regulate the rates of Category I carriers. This limitation is not made applicable to Section 213(e), and it is not clear whether this is inadvertent or intentional. Another major change is that the Commission's power of evaluation is extended to "any exchange carrier which originates, terminates, or transfers interexchange telecommunications." This is a much needed provision in order to give the FCC control over the rates for local distribution facilities of exchange carriers used by interexchange carriers as part of their interexchange services. MCI supports these proposed revisions. It suggests, however, that all of Section 213 except subsection (a) be deleted. This section was included in the 1934 Act because it was not then known whether the courts would allow a carrier's rate of return to be set on the basis of original cost of plant or would require use of reproduction cost new. That question has now been resolved, and the Commission makes use of original cost. MCI is advised that Section 213 has never been used, so the Act can be simplified by retaining just the broadened general power to make a valuation of the property of a Category II carrier contained in proposed Section 213(a) and then deleting the rest of the section.

Section 216 of S. 611 amends *Section 214* of the 1934 Act dealing with the authorization of carrier facilities. The new section provides that Category I carriers need only notify the Commission when they undertake the construction of new interexchange facilities, or the extension thereof, or wish to acquire or operate any such facility or to engage in telecommunications over such facilities. With respect to the requirement of similar notification by a Category II carrier, however, the Commission is authorized to require that carrier to obtain a certificate of convenience and necessity for such activities—and for the discontinuance or impairment of its telecommunications service. The Commission, in the alternative, may authorize a long-term facilities construction plan for a Category II carrier, which may then proceed in accordance with the plan without obtaining separate certification for each element of it. The Commission's power to require the construction of facilities to maintain adequate service for the public is also confined to Category II carriers. All of this is appropriate in view of the fact that Category I carriers, since they function in a competitive environment and are subject to competitive stimuli and constraints, need not be subject to detailed regulation. Section 214(e) contains a new provision for joint planning by two or more carriers under the auspices of the Commission whenever it may be necessary for the effective design, maintenance, and management of facilities required for the provision of switched public message telephone service. If such planning involves competitors, or if it may impact competitors unfairly, this section would help ensure that no one was put at an unfair disadvantage.

Sections 217, 218, 219, and 220 of S. 611 amend Sections 215, 217, 218, and 219 of the 1934 Act in minor ways, largely to accommodate the concept of Category II carriers. All these changes seem desirable.

Section 221 of S. 611 amends *Section 220* of the 1934 Act dealing with carriers' accounts and records. The principal change is a command to the Commission, within one year, to prescribe a new system of accounts for separate services or products to permit complete differentiation between competitive and non-competitive offerings. In view of the urgent need for a better system of accounts, and the time already spent on its development, this insistence upon prompt completion of the task is

desirable. It should be made clear, however, that the system of accounts prescribed by the Commission shall apply to any exchange carrier which originates, terminates, or transfers interexchange telecommunications because the Commission will need cost data, in consistent form, from such exchange carriers in order to administer the basic exchange maintenance program provided for in new Section 227. MCI believe it would clarify Section 220 if the word "divestiture" at page 50, line 5, were changed to "separation".

Section 222 of S. 611 makes minor amendments to Section 221 of the 1934 Act, which deals with consolidation or acquisition of carrier property. These changes apparently include deletion of subsection (c) and (d) of Section 221 dealing with the present scheme of jurisdictional separations. These changes seem appropriate—the latter because S. 611 uses a different approach to this matter in the new Section 222 it proposes.

Section 223 of S. 611 amends Section 222 of the 1934 Act by redesignating it as Section 222(a) and providing that it shall cease to have any effect a year after enactment of the amendments. Present Section 222 deals with consolidations and mergers of telegraph carriers and with international record services. These are matters as to which MCI has no particular expertise.

Section 223 of S. 611 also amends the 1934 Act by adding a new Section 222 dealing with a new Basic Exchange Maintenance Program. This section provides for the termination of present separations and settlement procedures 180 days after enactment of S. 611, and for the substitution of direct payment, from interexchange carriers to local exchange carriers, for the actual costs of originating, terminating, or transferring interexchange services, plus surcharges to support the continued availability of basic exchange services at affordable rates. MCI submits that Section 222(a) should further provide that "actual costs", where joint or common costs are involved, should be determined on the basis of relative use of common plant. Section 222(b) expressly provides that the use of intraexchange facilities for the origination, termination, or transfer of interexchange telecommunications shall itself be deemed interexchange telecommunications subject to the jurisdiction of the FCC. MCI agrees that this use of intraexchange facilities should be within the FCC's jurisdiction—indeed, it feels very strongly that the continuation of this jurisdiction in the FCC is vitally needed if competition is to grow. MCI also agrees that interexchange carriers should pay rates which are based on costs for the use of intraexchange local distribution facilities. Surcharges are, however, a different matter. MCI would be prepared to support the proposed surcharges, but only if and when it is assured that it will obtain intraexchange facilities and services exactly equal to those which the local telephone companies provide to AT&T's Long Lines Department. The fact is that MCI is at present receiving from the local telephone companies interconnection facilities and services which differ substantially from, and are significantly less useful to MCI than, those accorded AT&T Long Lines, MCI's only really significant competitor. It is also a fact that unless somehow compelled, AT&T will continue this patent discrimination indefinitely into the future. Assuming that nondiscriminatory local interconnection does become a reality, MCI would then be willing to pay a surcharge (above actual cost) for intraexchange facilities and services even though MCI does not believe that the use of surcharges is the fairest or economically most efficient way to distribute the costs of telecommunications services, and despite the fact that MCI believes that AT&T's oft-repeated claims as to the differential between its costs and revenues for residential exchange service are distorted and misleading.

Section 222(c), specifies how the surcharges are to be collected and disbursed. The total amount to be collected from all interexchange carriers, including AT&T's Long Lines Department, is to be 110 percent of that portion of the aggregate amount collected and distributed through the jurisdictional separations and settlement procedures during the year preceding passage of S. 611 which exceeded the actual cost reimbursement to the participating local telephone companies. MCI further understands that this sum, once determined, is to be the total collected each year thereafter, but that the share paid in by the different interexchange carriers will vary from year to year according to the percentage that each carrier's interexchange revenues bears to the total of such revenues for all carriers. MCI's primary concern is with the payments that it and the other new carriers will have to pay and is reluctantly prepared to accept the formula proposed in Section 222(c) as a compromise. However, MCI finds the provisions as to disbursement of the fund confusing and suggests that they should be clarified.

Sections 224 and 225 of S. 611 make rather minor changes in Sections 223 and 224 of the present Act. MCI has no objection to any of the proposed modifications.

Section 226 of S. 611 adds new Sections 226 through 231. New Section 226 deals with definition of exchange areas and apparently replaces present Section 221(b)

respecting exchange areas which traverse state lines. However, it does not explicitly exclude rates and terms for such service from the jurisdiction of the FCC, if that is intended. New Section 226 wisely provides that no exchange area shall extend beyond the boundaries of any standard metropolitan statistical area. It also specifies that every point within a state shall be included within an exchange telecommunications area. This may require expansion of some presently existing extended area services and would not prevent charging for service on a usage and distance-sensitive basis.

New Section 227 deals with carriers which engage in the retransmission by any closed transmission medium of broadcast signals or other cable television services. MCI is not engaged in any such operations but agrees that special measures like those outlined in this section are needed where carriers providing service for which they are not subject to effective competition wish also to provide cable television service.

New Section 228 is a very salutary provision stating that nothing in Title II of the 1934 Act, as amended by S. 611, shall be deemed to affect the applicability or enforcement of the antitrust laws. MCI believes this to be the case today but nonetheless strongly supports this explicit provision.

New Section 229 seeks to nullify the 1956 consent decree in *United States v. Western Electric*. In MCI's opinion, however, it tries to do this in a very awkward manner. The new section provides that telecommunications equipment or information services or equipment offered by AT&T "shall be deemed to be regulated common carrier communications services or equipment." But new Section 203(a) specifies that such equipment and service shall not be deemed to be a telecommunications service. If the Congress believes that AT&T should be freed from the restrictions of the consent decree—in which case it must be satisfied that its provision for the offering of such services and equipment through fully separated entities will prevent the abuses at which the consent decree was aimed—then it would seem simpler and more logical to say that it is no longer in the public interest for AT&T to be excluded from the computer and other communications-related fields. The present language also seems to conflict with the definition of "telecommunications carrier" in new Section 103(35).

New Section 230 deals with the ownership or control of telecommunications facilities and seems designed to avoid excessive concentration of control of the media—presumably meaning radio, television, cable television, newspapers, magazines etc. However, the relationship between carriers and cable television is covered in new Section 227, and MCI is not aware that telecommunications carriers pose any problem as to the other media listed. Read literally, this section would seem to require the Commission to limit the quantities of common carrier facilities (e.g., telephones, central office switches, microwave towers, multiplex equipment, etc.) which can be owned by a single entity. That may be desirable, but whatever is intended here should be more clearly stated.

New Section 231 deals with Commission authority over exchange carriers. It authorizes the Commission, by means outlined in new Section 205, to prescribe conditions governing the marketing by exchange carriers in interexchange commerce of telecommunications and electronic equipment and information services or software. It then says that, beyond that power and those provided in eight other enumerated sections, "The Commission shall impose no requirement on any exchange carrier." MCI believes that Section 220 should be added to the eight others listed in order to reinforce the fact that the Commission prescribed system of accounts applies to exchange carriers. With that change, the approach taken in Section 231 is appropriate since the sections listed give the FCC all the authority over exchange carriers it needs.

Section 227 of S.611 provides that nothing in the Act shall be construed as expressing any sense of Congress with regard to any litigation pending on the date of enactment. While it seems clear that S.611 would not adversely affect already accrued legal rights, MCI supports this explicit statement. It is not clear where, if anywhere, this fits into the 1934 Act.

Title IV of S.611 includes a number of minor amendments to sections in Titles IV, V, and VI of the 1934 Act. These merely convert references to "common carriers" to "carriers", "telecommunications carriers", or "Category II carriers" as is appropriate, and change "interstate" and "intrastate" to "interexchange" and "intraexchange". These amendments merely conform these sections to the changes in the sections discussed above. MCI supports them all.

Title V. of S.611 provides for a temporary National Commission on Spectrum Management to study ways of improving the allocation, assignment, and authorization of use of the electromagnetic frequency spectrum in order to promote certain stated objectives. MCI certainly has no quarrel with the purposes of such a Commis-

sion, but it is concerned that too much will be expected of its work and that there may be delays in taking other steps to deal with problems in the areas touched upon because of anticipation that the Commission may develop solutions for those problems. While it is quite likely that one could devise a better scheme for allocating and assigning the spectrum, MCI believes that the benefits of the Commission's study are likely to be smaller than hoped for by the framers of the bill. MCI feels that the major needs in this area are for (1) better coordination between governmental and private uses of the spectrum, (2) better staffing of the Commission's efforts in the allocation field, (3) strict enforcement of the Commission's allocation policies, and (4) the requirement of careful coordination of the use of the spectrum by private nonbroadcast users of the frequencies. MCI is not sure a special Commission is needed to achieve improvements in these areas. It does not oppose creation of such a Commission, but would urge that its existence not be used as an excuse for delay in doing other things to improve telecommunications service to the public.

COMMENTS OF MCI COMMUNICATIONS CORP. ON S. 622, THE TELECOMMUNICATIONS COMPETITION AND DEREGULATION ACT OF 1979

MCI is pleased to submit its comments on S.622, the Telecommunications Competition and Deregulation Act of 1979. MCI strongly supports the general pro-competitive thrust of the proposed legislation, as well as many of its specific provisions. It believes, however, that other provisions should be modified in order to achieve the stated purposes of the bill.

Section 2 of S.622 contains a series of congressional findings and a statement of the purpose of the Act. MCI concurs in the latter and in the first two findings. It believes that the third finding should be changed to something like the following: "(3) judicial interpretations of certain decisions of the Federal Communications Commission have demonstrated the need for statutory expression of the national policy of the United States in favor of competition in the provision of telecommunications common carrier services." That more accurately ties the judicial decisions to the basic thrust of S.622.

Section 101 of S.622 adds a new Section 6 to the Communications Act of 1934 dealing with fees to be collected by the Commission from all persons regulated under the Communications Act. MCI supports the provisions of this section because the fees provided for are to be based on the cost to the Commission of processing applications for license and tariff filings, plus the costs attributable to regulating such person. The last provision is a bit vague, but seems to be particularized by the reference to "the cost of providing any service necessarily rendered to a license applicant as a result of such application." MCI agrees that is a proper category of costs to be recovered through the proposed fees.

Section 201 of S.622 amends Title II of the 1934 Act by adding a new Section 225 dealing with the promotion of competition and deregulation. Section 225(a) sets forth five purposes of the section. MCI concurs with all of these, and particularly with the fourth one which is a good statement of intent to prevent predatory or anticompetitive practices in the provision of telecommunications service.

Section 225(b) sets forth a statement of the policy of the United States in order to accomplish the purposes of subsection (a). MCI supports without question all of the policy statements except the first, third and ninth, and especially commends the second, fourth, and fifth which assert federal jurisdiction over all interexchange telecommunications services and ensure that interexchange carriers can interconnect with the facilities of local telephone exchanges upon reasonable request. MCI agrees in principle with policy statements one, three, and nine, but has reservations as to their implementation. Statement one would "allow" basic voice-grade telephone service (which, as defined, is local exchange service) to be provided as a regulated monopoly until the appropriate state commission determines that competition will maintain reasonable rates and promote improved service through new technologies. That reflects the situation as it exists today, but MCI believes that the bill should also provide that Congress can open up exchange service to competition if that seems in the public interest at some future time, even if the Commissions in certain states preferred to continue the service as a monopoly. MCI is also concerned that statement three is not adequately implemented by other provisions of S. 622. MCI agrees that a single carrier could be permitted to provide both "the monopoly service" (it is not clear precisely what this refers to) and other telecommunications services if, and only if, it can be guaranteed that there is no cross-subsidization. However, MCI does not see any provisions in S. 622 which adequately ensure that result. Policy statement nine would allow any carrier to provide any telecommunications service or engage in any other lawful business. That would be all right if S. 622 required that certain operations be carried on through fully

separated entities in order to avoid cross-subsidization—but the bill does not require that.

Section 225(c) defines six terms for the purposes of this section. MCI has no problem with any of these, although it is not clear why a definition of "minimum universal transmission capability" is needed.

Section 225(d) provides for a six-year transition period during which it is hoped that the purposes and policies stated in this section will be accomplished, resulting in marketplace competition and the deregulation of the provision of telecommunications services:

(A) The Commission is to adopt regulations which classify carriers according to the degree of regulation necessary for each. MCI agrees that a classification of carriers is desirable and that the criteria listed are relevant, but it is not clear what the purpose of the classification is or what results will flow from a particular classification, how many different classifications are to be used, etc. A passing reference is made to ownership or control of a carrier by foreign interests. This should be tied in with Section 310(a) of the 1934 Act, which permits some degree of alien ownership, to ensure that there are no conflicts between the two provisions.

(B) The Commission is also charged with establishing an accounting system which will ensure that, where telecommunications products or services are provided by a carrier which also provides "the monopoly service", the revenues and costs of providing "the monopoly service" and all other services may be separately identified. MCI agrees that a new accounting system is needed, but the mere identification of the costs of different services is not enough. There must be assurance that the costs are then allocated by service so that there can be no cross-subsidy—a congressional directive to that end would be a desirable addition to this section. MCI further believes that the best way to prevent cross-subsidization is by establishing completely separate entities for the provision of monopoly and competitive services, respectively.

(C) The Commission is next charged to determine in which cases, if any, carriers which provide "the monopoly service" must form subsidiaries to offer any other telecommunications products or services in order to accomplish the policies stated in the section—but it is barred from requiring divestiture of any part of the carrier. MCI believes that the intent of this provision is sound, but that the Commission is not given adequate guidance or authority to achieve it. MCI believes that divestiture is the only sound way to achieve the competitive environment S. 622 is seeking, and that at the very least a directive is needed calling for the establishment of fully separated subsidiaries in specified cases.

(D) The Commission is also directed, through the Joint Board mechanism, to provide for an access compensation charge to be paid by carriers interconnecting their facilities with those of a local telephone exchange. MCI is prepared to pay an access charge based on the actual cost of providing interconnection service. MCI does not think that it should be required to pay any additional contribution unless and until it is accorded exactly the same forms of interconnection that the local telephone companies provide to AT&T's Long Lines Department. MCI also welcomes the provision that a contribution is to be paid only "if necessary to maintain reasonable rates for basic voicegrade telephone service". This reflects a healthy "show me" attitude toward AT&T's oft-repeated but never proven claims that it loses money on local exchange service. MCI also favors the provision terminating access charges and the access compensation fund after six years. Thereafter, inter-exchange carriers should pay for local interconnection under tariffs filed by the local telephone companies with the FCC, with rates based only on actual costs.

(E) The Commission is next directed, pursuant to the Joint Board mechanism, to provide for acceleration of the depreciation of assets used in providing telecommunications services. MCI agrees that any carriers which have under-depreciated their plant should be allowed to correct that situation, but it must be understood that this will significantly increase their costs over the next few years, which will mean either increased rates for service or reduced rates of return on capital.

(F) The Commission is told to provide that, during the first two years following enactment of this section, no rate for telecommunications services "other than the monopoly service" will be raised more than 5 percent or reduced more than 10 percent per year. For the next four years, it is to limit increases in such rates to 10 percent per year and reductions to 20 percent per year. While this is presumably intended to allow some flexibility with minimum regulatory intervention and perhaps as a rule of thumb to help prevent predatory pricing, MCI thinks that it would not be effective for the latter purpose. The formula specified would allow AT&T to reduce the rates for its competitive services by almost 67 percent over the six-year transition period. The legislation should not lend any kind of respectability to such sharp rate reductions—which could apparently be made even if costs were going up

generally, thus preventing the competing carriers from matching the cuts. It would be much better simply to continue to require adequate cost justification for reductions in competitive rates.

(G) The next charge to the Commission calls for changes in rates to take effect after ninety days notice unless the Commission, on complaint or on its own initiative, orders a hearing pursuant to Sections 202 and 204. MCI applauds this continued reliance on the nine-day notice period fixed by the Congress a couple of years ago—and assumes that the Commission's present suspension powers and the other provisions of Section 204 would be applicable to the hearing.

(H) The Commission is told to establish a procedure to ensure the interconnection of carriers providing telephone toll service with one another and with the facilities of local telephone exchanges. MCI applauds the intent of this provision, but is not sure about the means specified to achieve the objective stated. Thus, MCI is not sure what would be involved in an association of common carriers to manage the facilities providing telephone toll service and interconnection with the facilities of local exchanges, or what would flow from the broad authority given the carriers to meet, plan, and agree, with Commission oversight, on matters affecting the design, plan, maintenance, etc., incidental to such interconnection. MCI thinks there is too great a risk, absent additional safeguards, that such an association would develop anti-competitive policies—even if its meetings are carried out under some kind of Commission oversight. Who is to be entitled to join the association and attend the meetings? How are the decisions to be made, i.e., how are votes to be allotted among the participating carriers and what percentage of agreement is to be required for joint action? Would the meetings be so frequent as to be burdensome for small carriers? And while MCI appreciates the effort to bar any claim of exemption from the antitrust laws, it is not sure of the real effect of the formulation used. A single carrier can fix its own rates. Does the language at page 14, lines 6 to 10 provide any basis for a claim that the "association" can agree to rates for all of them because the setting of rates by a single carrier for itself would not violate the antitrust laws? MCI believes this provision needs substantial revision.

(I) During the transition, the Commission is to provide for automatic authorization, within ninety days, to construct or extend facilities by a carrier offering services "other than the monopoly service", unless the Commission determines that there is a substantial question as to whether the investment anticipated is in the public interest. MCI agrees that carriers seeking to construct or extend facilities for competitive services should be allowed to proceed with little or no regulatory action by the Commission, except for obtaining any necessary radio authorizations. However, if the carrier in question also provides "the monopoly service" and adequate steps (i.e., a completely separate entity) have not been taken to ensure against cross-subsidization, then the Commission will need greater control over the carrier's expansion plans.

(J) The Commission is directed to prohibit the discontinuance or impairment of telephone toll service unless the agency determines that it is in the public interest. This really doesn't change the present provisions of Section 214, so MCI has not objection, though it may not be necessary.

(K) The Commission, in its transition plan, is directed to provide a continuous review to ensure that nationwide toll services exist through marketplace competition. This is a worthy objective, but it is not clear how any continuous review can ensure the desired result.

(L) Finally, the Commission is to provide for adjustments in the transition plan to "remove marketplace deficiencies, anticompetitive behavior, or other practices which frustrate the purposes of this section." Again, MCI agrees with these objectives but feels that the Commission is not given adequate guidance—and quite likely would not have the necessary power—to achieve these goals.

The last three subsections of Section 225 provide for a separate Office of Deregulation to monitor the progress of the Commission in accomplishing the purposes of the section, calls for annual reports to the Congress on such progress, and provides for an evaluation of the results of the transition plan at the end of six years. These are all sound proposals and MCI has no problems with them.

Sections 202 and 203 of S. 622 relate to international telecommunications. MCI has had no experience in that area and so has no comments on these provisions.

The remaining sections of S. 622 deal with broadcasting, cable television, and the assignment of land mobile frequencies. MCI has no comment on any of these matters, except for new Section 335(f)(4) which directs the Commission to ensure that no carrier shall be a cable system operator or channel programmer, but that such carrier may furnish cable channels to a cable system operator or channel programmer and may offer broadband communications service (except program originations and the carriage of radio and television broadcast signals) to the public

pursuant to Title II. The Commission is authorized to waive the prohibitions of this paragraph in rural areas which are not otherwise served by a cable system. MCI believes this is a fair balancing as between carriers and the cable interests, and agrees that waivers should be confined to rural areas where service would otherwise not be available.

Senator HOLLINGS. I should explain something that may not be understood, we gave each one 10 minutes for an opening statement so then we will have time left this morning for a discussion between the panel members—and questions from the committee.

We next move to Mr. Hatfield.

Mr. HATFIELD. Thank you, Mr. Chairman.

I appreciate the opportunity to testify on the question of access charges. I believe the question of access charges and related questions of jurisdiction are among the most fundamentally important of those addressed in the legislation.

I would note that I am testifying this morning on behalf of myself and not on behalf of the administration.

I have three points, or ideas, that I would like to leave with you this morning:

No. 1, I feel that there are major weaknesses in the existing separations and settlement process.

No. 2, I would like to indicate our support for the access charge concept as a replacement for separations process.

And third, I would like to urge that the dual jurisdiction over local exchange facilities and operations be eliminated. It is this dual jurisdiction that makes the separation process necessary in the first place and, of course, adds to it and makes it more complicated.

We believe that the State should have responsibility for all intraexchange services, including the access charge itself.

I spoke of the weaknesses in the separations process. Let me detail them for you. First of all, the existing separations process is extremely complex. I think it is fair to say that it is fully understood by only a handful of people in the communications business. It is not readily susceptible to public accountability. It is extremely cumbersome. The process is difficult, because it requires agreement among the FCC, the individual States, both collectively and individually, with the Bell system and with some 1,500 independent telephone companies.

I think it is fair to characterize the separations process as a result of rate base regulation in a fairly stable monopoly market. It certainly does not have the sensitivity and responsiveness that you require in a competitive marketplace.

My second point is that the separations and settlements process I think pretty clearly distorts economic incentives. It comes down to being a cost-plus system. And with the increasing percentage of costs being transferred to the interstate jurisdiction, that cost-plus feature gets worse and worse.

Without going into detail, I think it is pretty clear that the existing process may impact on the choice of technologies in the local distribution area. I think significantly, as Chairman Zielinski testified before you here last Tuesday, it can even prevent deregulation. He said that they would have deregulate terminal equipment. One of the primary reasons they did not do so in New York

State was the possible impact on separations and settlement that would flow to the State of New York.

Third—the third problem with the existing process is that the present jurisdictional boundaries on which separations are based are not particularly compatible with the communications marketplace, the industry structure, or the physical network.

This means that a significant portion of the total telephone plant, including the local loop, is subject to both Federal and State jurisdiction. What I am saying is that the pair of wires that leads from your telephone in your office or your home down to the central office is subject to both the Federal and State jurisdictions.

In order to resolve this overlapping jurisdiction, you must have some method of dividing the investment. We feel that this forces a division into something that doesn't need to be divided in an operational sense.

Having talked about the weaknesses in the separations process, I think it is pretty clear that because of this cumbersome nature, the distortion of the economic incentives, the impact on technology and so forth, that we would fully support the provisions of S. 611, which would abolish the separations process and substitute an excess charge arrangement.

As Henry Geller stated last Tuesday, our only real reservation is that under S. 611, interexchange communication would be defined to include the origination and termination of interexchange traffic that would be under Federal jurisdiction. That is, while I think S. 611 is intended to clean up the jurisdictional situation—by putting intraexchange under local jurisdiction, interexchange under Federal jurisdiction—by allowing Federal jurisdiction over the termination and origination, you are right back where you were before of having two jurisdictions, at least as we understand it.

In other words, there would still be a dual jurisdiction over the local distribution of interexchange traffic. We think because of that you would be left with many of the same problems we have today.

Therefore, it is our recommendation that the States be given full responsibility for all local services, all intraexchange services, if you will, including the origination and termination of interexchange traffic. We think they ought to have the power to change the rates related thereto—in other words, to have control over the access charges.

Our reasons for this are numerous. I think the States are closer to the problems of the local operating companies. As Chairman Zielinski pointed out last week, the States are in a better position to examine and respond to the operations and behavior of the individual operating companies. They are in a better position to look at the overall revenue requirements and balance the revenue requirements—the revenue requirements of the particular company.

Furthermore, we think that it avoids unnecessary Federal intrusion in an area where perhaps it is unnecessary. That may sound somewhat revolutionary, but it's not the case. It really is analogous to going back to what was called board to board—essentially analogous to the board-to-board principle used 30 to 40 years ago in the telephone industry.

I think it made a certain amount of sense then when Western Union was competing with the long distance telephone service of A.T. & T., and I think it makes sense again now that we have competing intercity carriers.

I recognize fully what the problems with this are. It is conceivable that the States could abuse the power by establishing access rates or conditions that are excessive or discriminatory.

Furthermore, I recognize that the competing carrier, such as MCI, may prefer Federal jurisdiction for the simple reason that the States in the past have opposed the introduction of competition in the intercity services.

My answer to the criticism is really twofold. First of all, I think if the Congress expresses its opinion on communications policy and expresses an opinion that competition in intercity service is a good thing, I see no reason why the States wouldn't obey the law.

I think part of their opposition up until this point has reflected the fact that the policy—national policy—has been uncertain. I think this legislation would clear that up.

I think, second, if there are remaining concerns—then those concerns can be dealt with by guidelines and safeguards within the legislation itself. I think that the overlapping jurisdiction is not the way to do it.

I have mentioned safeguards and what do I mean? I won't give you an exhaustive list, but let me suggest some of the things that could be done.

First of all, to prevent excessive charges, one can put a cap on the amount of money that could be collected by the States. As I understand S. 611, you would do this essentially for each carrier. You would fix the amount that each carrier could get from the access charge.

We would just simply, say, put a lid or cap on the amount that each State could collect. We believe that kind of arrangement—maybe not that specifically, but something like that—would be a way of preventing States from unduly burdening, if you will, interstate commerce.

The second problem, of course, already alluded to, is the problem of interconnection and discrimination. We think by strong language in the act saying that, "Look, exchange carriers must interconnect and do so on a nondiscriminatory basis," would be adequate.

S. 611, of course, calls for that and gives the FCC jurisdiction for enforcing it. We don't think it is necessary if you make it strong enough. We believe the court enforcement would be an adequate remedy.

If you do this, if you give the State jurisdiction, you would eliminate the need for a permanent, cumbersome joint board. We believe it would be much more responsive. There wouldn't be the dual, overlapping jurisdiction, and you would eliminate the cost-plus features of the separations and so forth.

In summary, very briefly then, we support the idea of elimination of the separations process. We fully support the idea of substitution of an access charge. Our only suggestion would be elimination of the overlapping jurisdiction, giving the States the freedom

to regulate all intraexchange services, including termination of interexchange services.

Thank you.

Senator HOLLINGS. Thank you very much.

Mr. Bahnson.

Mr. BAHNSON. Thank you, Mr. Chairman.

GTE agrees with the conceptual intent of the bills provisions that all interexchange service carriers which directly or indirectly connect with the local exchange be required to reimburse telephone companies directly for the costs of originating, terminating, or transferring interexchange services, through what has been described as an access charge.

However, we believe that the access charge should be paid by all providers of interexchange services and not be limited only to common carriers.

Senator HOLLINGS. You mean protecting carriers?

Mr. BAHNSON. Not just carriers, all providers of interexchange service. Shared microwave is not a carrier.

In my comments today, I would like to offer my suggestions on application of the access charge. Specifically, I will address:

First, the definition of costs that make up the access charge, and

Second, the applicability of the access charge to indirectly connected interexchange carriers.

Since the access charge is intended to cover the actual costs of interexchange access, I believe this charge should reflect the local switching and trunking costs that vary with the amount of interexchange traffic carried over interexchange facilities—that is, the cost of traffic sensitive facilities.

In the long term, I believe the cost of traffic nonsensitive subscriber plant should be excluded from costs used to determine the access charge.

While the inclusion of a portion of the traffic nonsensitive cost in the access charge would help maintain the current level of interexchange settlements, it also may inhibit appropriate economic pricing of interexchange and intraexchange services in the long term.

If economic allocation of resources and economically efficient pricing of services are to be achieved, revenue should be more aligned with cost in the process of pricing access charges.

Under this approach, all traffic nonsensitive subscriber plant would be identified and eventually supported directly from rates paid by the local telephone company customer. Intraexchange and interexchange usage would be priced to cover the traffic-sensitive and related overhead costs.

The MTS/WATS contribution toward covering traffic nonsensitive costs would be eliminated in time, market equilibrium would be maintained between MTS/WATS and competing services, and MTS rates could be reduced.

Of course, in evaluating this proposal, Congress must recognize that this would result in a substantial revenue requirements shift from intercity services to local exchange service rates.

In order to eliminate the necessity for an immediate one-time increase in local exchange rates, which local service customers would have to pay, I would propose that the elimination of the contribution be phased in over time.

If, however, Congress concludes that public interest requires a continuing contribution by interexchange services to help keep local exchange rates affordable, I strongly recommend that all interconnected interexchange telecommunications be required to make comparable contribution. It should be recognized that in a competitive market the contribution must be at a level that will not deter providers of interexchange service from using the telephone companies service for access to customers.

My second point—I agree that access charges should be paid for interexchange services which indirectly access intraexchange facilities, as well as direct connections. Under present conditions, it is extremely difficult for a telephone carrier to determine whether a customer switches interexchange traffic through a PBX system to connect to the local telephone exchange facilities. It is incumbent upon the industry to develop some specific method to monitor and control indirect access to assure that all such access charges are appropriately paid.

In summary, GTE supports the concept of local exchange carriers providing physical interconnection for interexchange services with appropriate compensation to the local telephone company through an access charge.

Senator HOLLINGS. Very good. Thank you.

Mr. Jones, A.T. & T.

Mr. JONES. Thank you, Mr. Chairman.

As it notes, I am in Separations and Division of Revenues. I hope I can do something to clarify that subject for those who are here.

I would like to address the impact of the proposed legislation on the exchange part of the telecommunications business.

First, some preliminary observations are in order. In introducing S. 611, the chairman said, "Competition is a means to an end; it is not an end in itself. Where an important public goal is not served by competition, regulatory tools must still be available to ensure that essential public needs are met."

In no area, I believe, are those words more relevant than in the area of the local part of the nationwide network, for politics and decisions designed to foster competition can affect both the quality and cost of local calling.

Obviously, it is a difficult task for Congress to draft legislation that attempts on the one hand to assure continued universally available service at affordable rates and which creates incentives for innovative, efficient provision of telephone service, while on the other hand to gain the benefits of competition in the telecommunications area.

The proposed legislation—in particular, S. 611—contains sweeping and far-reaching proposals that I believe ignore the extremely intricate technical and financial relationships that exist in the telecommunications industry. In addition, the bills substitute in many instances completely untested and untried mechanisms for those systems that have evolved over the history of this industry—and have worked.

In my judgment, this approach will cause strains on local service and unnecessary economic dislocations for telephone customers and telephone companies alike.

Messrs. Sageman and Marshall have addressed in detail the impact of the bills upon service, but I would like to underscore one point. That is, while it may be convenient as a mode of thought to view exchange service¹—in fact, I think everybody at the table tends to agree with that—but great care needs to be exercised and conditions set as to how that interconnection is achieved.

Failure to do so risks fragmentation of the network that would ill serve the needs and the pocketbook of the Nation. The bills take too simplistic a view of defining exchanges. In particular, S. 611 provides that exchange areas not exceed the boundaries of the standard metropolitan statistical area. The SMSA may not be relevant in determining an exchange area. Exchanges are shaped and sized to meet the community of interest of the public.

In addition, there are numerous variations—overlapping extended local calling areas, for example—which appear to be difficult to accommodate under the proposed bills.

The intricate financial system of the separations and settlements—of long-standing—achieves a variety of goals.

First, it assures affordability and availability of high-quality service. Without question, it assures that carriers costs are recovered.

It also assures all carriers, large and small, sufficient economic incentive to make the necessary investments to provide quality service throughout the network.

S. 611 proposes to sweep these away and supplant them overnight with a new mechanism. We agree with the need for access charges and a reduction over time of the contribution to local service. However, this does not require the abrupt abandonment of time-tested procedures, which could be adjusted and have been adjusted over time. A studied transition is needed to assure equitable contributions from all services and to minimize the economic disruption of customers and telephone companies.

The proposed legislation fails to clearly set forth the respective jurisdictional responsibilities of State and Federal regulators. This poses the risk that certain costs, though incurred by the local carrier, that may not be deemed the responsibility of either regulatory agency, leaving the carrier to absorb the cost.

There has to be assurance that all costs will be covered. We urge establishment by legislation of an effective Federal-State joint board empowered to deal with a number of these transitional questions, including the nature and the level of the access charge, including a mechanism for phasing down the contribution to local rates; the conditions for interconnection to the network; the future of separations and settlements; the meshing of local rate increases with a phasing down of the contribution from State and interstate toll services; and finally, the delineation of the accountabilities and responsibilities of the Federal and State jurisdictions.

Thank you, Mr. Chairman.

[The statement follows:]

¹ As a discrete entity, such an approach is inadequate and entirely unrealistic in terms of network technology—as inadequate as viewing capillaries, veins, and arteries as separate entities, independent of the entire circulatory system. The fact is, we are speaking of a single integrated network service.

We accept the concept of providing interconnection to give local access to other carriers.

STATEMENT OF CHARLES JONES ON BEHALF OF AMERICAN TELEPHONE &
TELEGRAPH CO.

My name is Charles Jones. I am currently Assistant Vice President—State Regulatory Matters for A.T. & T. in New York City. During my 23 years in the Bell System, 20 of which were with New York Telephone, I have served in various regulatory assignments, including Service Costs, Rates, Bell Independent Relations and Jurisdictional Separations work.

I would like to address the impact of the proposed legislation, namely S. 611 and S. 622 upon the exchange part of the telecommunications business.

First, some preliminary observations are in order. In introducing S. 611 Senator Hollings said "competition is a means to an end; it is not an end in itself. Where an important public goal is not served by competition, regulatory tools must still be available to insure that essential public needs are met."

In no area, I believe, are those words more relevant than in the area of the local part of the nationwide network. For policies and decisions designed to foster competition can affect both the quality and the cost of local calling.

Obviously it is a difficult task for Congress to draft legislation that attempts on the one hand to assure continued universally available service at affordable rates and which creates incentives for innovative, efficient provision of telephone service, while on the one hand gains the benefits of competition in telecommunications.

The proposed legislation, in particular S. 611, contains sweeping and far-reaching proposals that I believe ignore the extremely intricate technical and financial relationships that exist in the telecommunications industry. In addition the bills substitute, in many instances, completely untested and untried mechanisms for those systems that have evolved over the history of this industry—and have worked.

In my judgment, this approach will cause strains on local service and unnecessary economic dislocations for telephone customers and telephone companies alike. Messrs. Sageman and Marshall have addressed in detail the impact of the bills upon service, but I would like to underscore one point. That is, while it may be convenient as a mode of thought to view exchange service as a discrete entity, such an approach is inadequate and entirely unrealistic in terms of network technology—as inadequate as viewing capillaries, veins and arteries as separate entities, independent of the entire circulatory system. The fact is we are speaking of a single integrated network service.

There is an intricate relationship among switching centers—local offices, tandem or intermediate switching centers, and toll centers—and the local and toll transmission lines that link them. As Mr. Sageman has pointed out, all of these elements of network service must be planned, designed, balanced, configured and managed in relation to one another in order to handle the flow of traffic to and from points across town, across the state, throughout the country and increasingly, today, around the world.

Local facilities—from a technical and service delivery standpoint—are no less an integral part of this network than the largest super toll switching machines or the highest capacity long distance transmission systems.

If one were starting from scratch to build a system where the exchange service was to be viewed as discrete from network service and if the inherent technological imperatives were ignored or "bent," such a view might be theoretically possible. But that is not the case with today's system that is in place and working.

That is why certain provisions of the proposed legislation are disturbing.

One of the provisions is the sharp distinctions that S. 611 proposes between exchange and interexchange carriers with no apparent reflection of how closely intertwined are the technology and facilities of each. These are not discrete building blocks that can be simply and readily pulled apart.

We accept the concept of interconnection to give local access to other carriers. But, great care needs to be exercised in defining the technical interfaces and setting the financial conditions for the interconnection. Failure to clearly set forth these conditions could create a situation in which there is no single, unified core communications system which is planned, designed and operated as one but rather a kind of random agglomeration of facilities that defies management, planning, operation and good service. This would, I believe, ill-serve the essential communications needs of the nation and the pocketbook of the public. The conditions for access to local networks by competing carriers is an area that has not been adequately provided for in the legislation. We believe that an effective Federal-State Joint Board should be empowered to deal with the conditions, technical and financial, for interconnection to the network.

In similar fashion, the proposed legislation takes too simplistic a view with respect to defining "exchanges."

Both S. 611 and S. 622 put the decision in the hands of the State regulators, but S. 611 also includes a provision that the exchange area not exceed the boundaries of any Standard Metropolitan Statistical Area. The SMSA may be a helpful demographic measure for some purposes but bears little relationship to conditions that determine what an exchange area should be and no relationship to the way billions of dollars of relatively fixed plant is now emplaced.

Exchanges today vary widely in their size and shape reflecting the community interest of customers, their calling patterns—in short their needs. The needs of customers and economic considerations as well shape the design of facilities, the development of rate plans and billing systems. Today we have many “traditional” single exchange areas, but we also have overlapping Extended Local Calling areas incorporating many exchanges as Mr. Marshall discussed in his testimony. In addition, we offer in some jurisdictions various choices where customers can choose a variety of communities, unrelated by geography, as part of their “local” area.

How such variations would be accommodated under the proposed legislation is at best unclear.

Beyond the intertwined, systemic nature of the technology of the network is yet another elaborate, highly complex financial system that has been developed over time in the telecommunications industry in order to achieve a variety of goals.

To assure that each carrier's costs are recovered;

To assure the affordability and wide availability of high quality service; and

To assure that all partners in the joint provision of network services have sufficient economic resources and incentives so they will make the investment needed for efficient, high-quality service through the entire network.

Obviously I am talking about the separations and settlements procedures. I will be quick to add that these procedures are not perfect in every respect—yet, they are deeply imbedded in the operation of the industry, imbedded in the structure of rates, and imperfect as they may be, they have essentially served their purpose well. They have assured high quality basic service at a reasonable price and contributed to the economic health of the entire telecommunications industry. They have an added benefit: they can be—and have been—adjusted to meet new needs without creating extreme fluctuations in price and severe economic hardships for the public or the variety of participants, large and small, in the industry. And gentlemen, this is the mechanism which makes it possible for Bell and 1,500 independent telephone companies—mostly small—to serve their customers and remain financially strong.

And so I raise the question: Is it necessary to sweep away this long-standing mechanism and supplant it virtually overnight with a new, untested, untried mechanism as proposed in S. 611? I don't think the answer to that question should spring from ideology but rather from an objective assessment of what will serve the goals of Congress with the least cost and the least economic disruption to customers and telephone companies.

In raising this question, I am not taking issue with the idea of access charges, administered fairly for all competitors, which reimburse the local carriers for the costs involved in the provision of the local facilities. In point of fact, I support that concept endorsed in each bill.

But let me take a moment to comment on our view with respect to access charges.

We believe that it is important that the access charge be composed of two clearly identifiable parts. The first to cover full actual costs—those costs associated with the volume of traffic and/or the facilities required by the connecting carrier. Second, a contribution designed to help keep local rates at an affordable level.

The first element—to cover full actual costs—should remain in effect as long as the interconnection is provided. As we read S. 622, the bill would appear to eliminate this cost recovery after six years. Since these costs of interconnection will persist, it does not seem sensible or practical to eliminate this aspect of the charge until such time as the interconnection is terminated. Therefore, this provision of the bill should be changed.

The second element of the access charge—the contribution—we believe needs to be gradually phased down, say over a period of 10 years. However, during its continuation, it is important that all competing services contribute on some equivalent basis.

We are then in basic agreement with respect to the need for an access charge so that local carriers can recover their costs and the reduction over time of the contribution to the costs of jointly used local facilities. We do, however, take issue with the abrupt abandonment of time-tested procedures that could, instead, be adjusted and even phased out over the same time period as the contribution element of the access charge. I would urge then, rather than creating a Commission-administered program as proposed in S. 611, the Basic Exchange Maintenance Program, that a Federal-State Joint-Board be established, to work within Congressional guide-

lines, to address both the nature of access charges and the adjustment or even eventual elimination of the separations and settlements procedures.

The level of the access charge will be affected by both technological and market factors. Even today there exists technologies, such as roof-to-roof antennas, that need no direct connection to the network. If the price for access is set too high, it would accelerate services that by-pass local facilities. Thus, the contribution portion of the access charge must either be phased down or perhaps out in concert with increases in rates for local service.

Balance of action is required. The balance of action as proposed in the creation of the access charge and the phasing down of the contribution should be weighed by both federal and state regulators—to lessen the impact on all customers and companies.

The current proposals create the difficult situation where the access charges are under federal jurisdiction, while local rates remain the responsibility of state regulators. This, in my view, is likely to lead to disputes over what costs are to be covered by, and the rates for, the access charge. The pressure on the federal regulator will be to minimize intercity costs and to standardize prices, which will in turn put upward pressure on the amount of local costs which may or may not be covered by increased local rates. The dilemma will be that the total cost of providing service will remain—but the local carrier may have no means of recovering them all. This sort of situation could create severe hardship and possible financial ruin for some companies. It also creates a very burdensome pressure on state commissions, which after all, face the consumer with far greater proximity than federal regulators.

The proposed legislation raises several concerns with respect to the consequences of the redefinition of regulatory jurisdiction—concerns that we believe need to be resolved by a Federal-State Joint-Board.

For example, if I read S. 611 correctly, intrastate toll services would no longer be under the aegis of state or local regulators. This poses a difficult problem—for it has been intrastate toll in every state that has helped state commissions to continue to maintain affordable basic rates. We estimate that in 1978 to contribution from state toll added some \$3 to \$4 billion on top of the \$5 billion contribution from interstate toward coverage of the costs of the jointly used local facilities. Just for sizing purposes, this \$3-4 billion is about twice the amount of rate increases that have been granted in all the state jurisdictions in any past year. If you add that to the contribution from interstate, this \$8 to \$9 billion represents more than all the state rate increases over the past ten years.

Let me be clear on this point: this is the amount of revenue that will have to come from increased local exchange rates if the contribution from both interstate and intrastate toll is eventually ended.

The contributions from intrastate toll have then been an important element in enabling state Commissions to keep the price of local service affordable. That option would not be available to the state regulators under the current proposal.

At some future time, when charges for local services fully cover all the local costs, this may not be so troublesome. But—in the interim—there needs to be assurance that local costs will be fully recovered.

New regulatory jurisdictions require clear definitions of authority, leaving no gray areas where costs are in "limbo." An example of this would be the allocation of spare facilities in local distribution plant. In order to serve the anticipated needs of existing or potential interexchange carriers, local carriers will have to maintain spare facilities. Under which jurisdiction does the cost of this spare fall? Until it is used by interexchange carriers, it could be argued that it has no relationship to the interexchange jurisdiction. On the other hand, the state regulator could hold that it is unnecessary except to provide interexchange service—and hence should not be a state cost covered by state rates. Nonetheless, the spare must be provided to respond to service demand and the cost must be covered.

Looking ahead, the only beneficiaries of the change will be the heavy users of intercity services who would see an overall reduction in their bills as the price for these services is driven down toward the floor of costs. On the other hand, local service rates will have to rise—also to reflect costs—as the contributions from intercity services are reduced or removed.

As one step in attempting to maintain universal service, while providing the customer options for controlling his bill, the Bell System is moving to measured local service. Measured service means unbundling local usage from the rate for basic service. Local usage charges will apply to the frequency, duration, and distance of calls—with provision for discounts for calling during off peak hours. Although basic rates must be raised, measured service will help minimize these price increases for customers who can control their local calling.

Yet even in a measured service environment the total charges from local rates will be significantly more than they are today once the intercity contribution is removed. Measured service will be no panacea that offsets the need for increased local rates.

What all this means, in one form or another, is that a heavier financial burden has to fall on the local customer. Even if "phased" over time, it should be clear that it means an increase in local rates that would surpass any other in history. Is the nation ready for that?

In closing, I want to stress my appreciation of the difficulty of trying through legislation to provide guidance and principles for what will be a new era in telecommunications, marked as never before by competition.

What I have tried to suggest are ways of achieving this new era without drastically affecting the price and quality of service and avoiding precipitous action that would create economic hardship for the public and the carriers.

I would leave with you these final thoughts.

One, it is essential to consider the differential effects on various classes of telephone users: business, residence, large users, small users.

Two, whatever the outcome, a period of carefully studied transition is essential.

Three, a careful meshing of federal and state responsibility is essential.

To do this, I believe, requires the establishment by legislation of an effective Federal-State Joint-Board empowered to deal with:

The nature and level of access charges, including the mechanism for phasing down the contribution to local rates;

The conditions for interconnection to the network;

The future of separations and settlements;

Meshing local rate increases with the phasing down of the contributions from state and interstate toll services; and

The clear delineation of the accountabilities and responsibilities of the federal and state jurisdictions.

Senator HOLLINGS. Thank you very much, Mr. Jones.

Mr. French?

Mr. FRENCH. Thank you for the opportunity to appear before your committee and offer my comments concerning the access charge provisions contained in S. 611 and S. 622.

I am Warren B. French, Jr., president of Shenandoah Telephone Co. of Edinburg, Va., an independent company serving about 11,000 customers in 8 exchanges. I am appearing on behalf of the Organization for the Protection and Advancement of Small Telephone Companies—OPASTCO—which represents 350 telephone companies serving 1,340,000 telephones in 1,178 exchanges located in rural America.

In view of the short time interval between the introduction of these bills and this hearing, OPASTCO is still evolving its specific reactions and recommendations. We will continue to review the many facets of the bills and share our insights with you.

My testimony therefore will deal with our present concerns about the application of the access charge to the extent the small telcos currently agree—it is pretty hard to find agreement in our organization on any issue—and will give in some cases my personal opinion as an individual with the experience of operating for the past 25 years an independent telephone company serving a small part of rural America.

Both the present settlement procedures for intercity service and the Rural Electrification Administration telephone financing program for small telephone companies in low-density rural areas have made it possible to furnish quality telephone service at reasonable prices to citizens throughout rural America and at comparable levels with our city friends.

I do not believe the Congress should enact any new legislation which will primarily benefit urban America, large businesses and

industry, if that legislation destroys or weakens rural telephone service.

Since rural America and urban America are different and the cost of providing telecommunications service in low density rural areas is greater than in urban areas, OPASTCO believes:

One, the existing amount of money per toll message to support universal rural telephone service which currently flows from intercity tolls must continue.

Two, any legislation must guarantee fair competition and must not burden rural companies with greater regulation or administrative costs.

Three, rural America must have the opportunity to benefit from new telecommunications technologies available to urban America.

Specifically this means:

One, and I think this is very important—Nationwide average toll rates—that is, continued parity between rural and urban services and rates—should be explicitly mandated in this legislation.

Two, all interexchange services must support and pay for the use of local exchange facilities. The level of support from toll must remain at existing unit levels.

Three, all interexchange service providers should have access to the local network and should compensate local exchanges for this access.

Four, carriers who choose not to connect directly or indirectly with local exchanges should pay an availability charge to support the local network.

These specific goals can be best accomplished by:

One, allowing the present separation and settlement principles which have maintained universal service at reasonable rates to continue essentially intact today and keeping to a minimum any disruption to the existing settlements process.

Two, placing all intercity service under FCC jurisdiction, and eliminating the present inter-intrastate rate disparity.

Three, use ENFIA-type access concepts to insure that all competitors to the interexchange network including Bell's FX, CCSA, and other toll diversion services pay a fair contribution.

Four, apply a surcharge on interexchange equivalent carriers furnishing nonconnected service as an availability charge, which would be used to help maintain average, nondiscriminatory intercity toll rates, or could be turned over to REA to support rural service.

I would now like to turn to the access charge provisions in Senate bills S. 611 and S. 622.

Mr. Chairman, your bill clearly recognizes the financial problems of furnishing telephone service in rural America, as is readily apparent from the bill's provisions for an access charge, the basic exchange maintenance program, special funds for small companies with fewer than 30 subscribers per mile, and a surcharge on unconnected carriers.

The bill, however, does not mandate nondiscriminatory intercity rates; it does increase Government involvement through the local exchange maintenance process; and it reduces, over a period of time, the relative flow of money to support local exchange service.

I recommend that this bill be amended in the following ways:

One, to provide for nationwide toll rate averaging—i.e., non-discriminatory rates—including making available volume discounts to all customers, urban and rural. This would make the interexchange network more competitive and increase utilization of that network.

Two, to have the access charge apply to any intercity exchange services whether they are connected directly or indirectly.

Three, to minimize any disruption to the present separations and settlements process.

Four, to allow the surcharge on unconnected carriers to support nationwide average—that is, nondiscriminatory—toll rates.

Five, to utilize any new settlements process and access charges to maintain local exchange service rather than the proposed basic exchange maintenance program.

Six, to eliminate the special funds to maintain the viability of small rural systems as these funds would be lost in regulatory proceedings before the State commissions. I like the idea that you wanted to give to us, but the end result would be lost in State regulatory provisions. It is more important that these funds be used to assist in insuring nationwide toll rates which do not discriminate against rural areas.

I am grateful to you, Senator Hollings, and your staff for recognizing our financial problems in rural America. I believe my suggested changes will accomplish the same objectives with less regulation and more certainty that our rural America would continue to receive local and long distance service on an equal basis with urban America.

With regard to S. 622, it appears that Senator Goldwater's bill would not result in greater administrative burdens for small telephone companies. However, the bill requires the FCC to establish a joint board to develop an access charge to support local exchange facilities that would be eliminated after 6 years.

The bill does not explicitly address the problems of continuing to furnish adequate local and intercity telephone service to rural America at reasonable rates in a competitive environment.

I am aware that Senator Schmitt, in cosponsoring this bill, said:

Another topic for discussion will be the possible need for specific provision on improving telecommunications services in rural America by ensuring that new technologies are available to rural residents as well as to those presently more easily served in urban areas.

I believe the bill should be amended to explicitly deal with the rural issues and to incorporate the changes I have recommended for S. 611.

In closing, I wish to call the committee's attention to Congressman Van Derlin's bill, H.R. 3333, which provides for an access charge developed by State jurisdictions rather than the Federal Government. An access charge developed by the various State jurisdictions merits consideration since the access charge is for the support of local facilities which will be furnished under State regulation. This committee may wish to give this proposal serious consideration.

In summary:

One, please insure legislatively that rural America will not face discriminatory interexchange services, charges for those services.

Two, use separations and settlements principles and access charges to support local exchange service.

Three, use access charges like ENFIA to insure that all services—including those provided by Bell—competing with the inter-city toll network pay their fair share.

Four, provide a surcharge on all unconnected services to support and maintain nationwide average toll rates.

Mr. Chairman, I want to thank you for this opportunity to appear before your subcommittee on behalf of OPASTCO.

Senator HOLLINGS. Thank you.

Let me, at the outset, ask that all of the statements in their entirety be included in the record.

Mr. Jones, we want your statement included, also. You did not have time to put it all in.

Mr. French, with respect to the FCC, it appears that you would rather the FCC do its regulating on this access charge; then at the conclusion of your statement you state that the Van Deerlin bill requires a State to do it.

Mr. Hatfield made a persuasive argument that we do away with joint boards, and the States, being closer to the particular problem, have the availability of facts, changing conditions, to determine a reasonable access charge and exchange rate.

The fact of the matter is, there is great apprehension obviously that the States just get revenues and will ratchet it up and up.

But let me get it clear. Do you want the States to do it? Or the FCC?

Mr. FRENCH. If I felt that the States could see that we would continue to receive adequate revenue, then I like regulation at the State level.

But I am concerned that when we go that way, that the legislation provide for an adequate return. At the present time, rural America has the advantage—if it is an advantage—or the need for average toll rates. If we are going to change this all around and compete, then is rural America going to pay higher toll rates and also pay for higher local service? At the present time, we use the Bell rate of return in our settlements. If we go to the State commissions, am I going to end up using a lower rate of return—which is what we happen to have—and therefore not continue to get that same level of support?

So it is a very complicated item. It is desirable to do it at the State level, but if it is done we don't want to end up with rural telephone companies not having adequate funds to support their companies.

Senator HOLLINGS. Mr. Hatfield, Mr. French is talking about providing nationwide toll rate averaging. That is, nondiscriminatory rates including making available volume discounts to all customers, urban and rural. This would make the interexchange network more competitive and increase utilization of that network.

How do you view that?

Mr. HATFIELD. I am not sure I understand completely the volume discount.

Let me clarify one point that I think is important. When we talk about universal service, I believe it has two components.

First of all, I have to be connected from my home to the central office. That is so I can call the doctor, or whatever. And let's make sure that people have access to the local network.

And then there is the second problem of making sure that my local exchange is connected into the nationwide network, and the cost of getting into that nationwide network from my local network is not excessive.

I believe it is important to distinguish between those two aspects of universal service. The access charge, as I understand it in the bill before you and in our concept, would be used to make sure that the subscriber access to his local network is at a reasonable rate.

The other aspect of it—I am afraid you are mixing two things—the other aspect is: Will competition cause deaveraging, so the rates for the more rural exchange into the network will be higher than the access into the network from the metropolitan exchange?

The studies we have done so far—and they are not conclusive yet—but the studies we have done so far indicate that that deaveraging will not be excessive. So I think we can separate the two. The access charge supports the access to local service. I may have avoided your question, but I think it is important to draw the distinction when we are talking about universal service.

Mr. FRENCH. I suggested the volume discount. The problem we have is getting people to use the network. The private lines come in and pull the revenue off of the toll network, and that affects rural company settlements. WATS is a method of that; private line service is a method of that.

You could also have volume discounts for the customer with a \$1,000 bill. He is now paying a higher proportion of supporting local telephone service without any relation to what his usage is.

If we can have volume discounts to recognize that, then give him a 10-percent discount. That will encourage him to stay on the network and that would eliminate the duplication of facilities to the degree that the network can handle that traffic.

If it can handle that traffic, then the local network is going to participate in that subscriber line usage in dividing those costs up.

Senator HOLLINGS. I am thinking of your principal point: To insure legislatively that rural America will not face discriminatory interexchange services. But there is guaranteed competition under this bill, but at the same time guaranteed that rural America won't suffer from competition.

Can that be done, legislatively? Do you think we can guarantee that?

Mr. FRENCH. I think we can guarantee average toll rate. And in doing that, that doesn't mean that you can't have volume discounts.

All I am saying is, if you are going to give a break to the metropolitan areas, rural America should also have them. Instead of having the high and low rates which have been proposed, just continue to have the average toll rate. That doesn't mean they won't be reduced, but if you are going to reduce them in urban areas, reduce them in rural America.

Senator HOLLINGS. How about that, Mr. Jones? Can you do that?

Mr. JONES. I have to agree with Mr. Hatfield that initially at least I would not foresee great disruptions in the toll schedule as it presently exists.

However, I think over some prolonged period of time that there would tend to be a deaveraging, or at least restructuring, of the intercity toll rate.

So I don't know that I can assure Mr. French of the continuation of average toll rates. I think it would be a period of time before you would see major changes.

Senator HOLLINGS. What about that, Mr. Hatfield? Can you guarantee competition and protection for rural America in one bill?

Mr. HATFIELD. I think that you have open entry. And open entry means the freedom to enter and exit, both. Then you can't force nationwide rate averaging.

The question is: Will it be severe? Would it be harmful to rural Americans? That is the issue.

In other words, if you are going to force a person to serve a noneconomical route and lose money, then you have to guarantee him excess profits somewhere else. And when you do that, it attracts entry wherever there is excessive profits.

As long as you have open entry, I don't think you can guarantee that you won't have some deaveraging. Again, I go back to the question of: How much deaveraging? And that is what we have to focus on.

I would point out, for example, that there is deaveraging now. You pay a little bit different for an interstate call than an intrastate call. There is some deaveraging in the way we regulate today.

Our studies seem to indicate that it would not be severe, if the Congress was concerned about that. I think our recommendation would be—rather than to limit entry, rather than to keep competition out, rather than guarantee or allow certain monopolies—we would suggest a safety net in terms of specific subsidies for these situations which are in very rural, sparsely populated areas.

Mr. FRENCH. Mr. Chairman, you say it is not significant. Then if it is not significant, there is not a problem of doing it. There is another reason why I believe there should be a surcharge on all unconnected carriers. Unconnected carriers, if they wish, can use a satellite without redundancy and get it up at half the cost. But, if that fails they dump their traffic over on us. We will get revenue when they do that, but what really happens is our customers suffer because of the overutilization of the facilities that occurs.

They should pay a surcharge to protect that network and that could be used to maintain average toll rates throughout America.

Senator HOLLINGS. I want to yield to my colleagues. Mr. Jones, and you, Mr. McGowan. We could have a day-long hearing with you two gentlemen.

Mr. JONES. Only a day?

Senator HOLLINGS. If you had sufficient time, you would more or less describe the separations. It is a candy jar. As long as you are a good boy, you get a little bit more of the candy from A.T. & T. If you are not a good boy, you don't get it.

Did you have time to explain exactly how you operate the candy jar?

Mr. JONES. Sitting here between the two glass walls of the two partners, I would hate to characterize it as a "jelly bean jar," or something of that nature. We are providing a process by which we identify the costs of not only the local, but the intercity operations as well.

And based on those statements of cost, we then in turn take the revenues—this is the settlements end of the process—that are obtained from the billings to the customer, and then distribute them back to the companies in terms, first, of the expenses that they have incurred in providing the interstate or intrastate toll service, and then as to what remains we pay a uniform rate of return, or settlement ratio, to each of the partners.

Each of the Bell operating companies and each of the independents get that same rate of return or ratio each month. So it is not a cookie jar, or candy jar process. It is one that clearly has enabled us to support local rates through this contribution toward costs of the local service.

It may be complex, but so is the 1040 form, I suppose. It must be somewhat less than complex, if 1,500 independents and Bell companies can utilize it each month and explain it to their auditors and the regulators.

Senator HOLLINGS. Do you want to comment on that, Mr. McGowan? In addition to it, you said no local exchange carrier would give A.T. & T. long-lines, broad-band interface. They won't give that to MCI. Can you elaborate on that?

Mr. McGOWAN. Yes; I can comment on the remark by Mr. Jones. I believe that any system—whether you call it separations and settlements or accounting systems—which permits you to spend about \$55 billion a year—where the average family in the United States is spending directly or indirectly close to \$700 a year for telephone service—and still have no idea what your costs are, then that system is deliberately imprecise. Bell just sits there and says, as its chairman will say, "I don't have any idea what anything costs; I don't know what my costs are." This ignorance results from a messy bookkeeping system which I maintain is obviously messy on purpose.

Anybody who is part of the settlements pool has a very comfy life. All you do is get all of your expenses back. And on top of that, you get a guaranteed rate of return. I would be willing to put up with a benevolent dictatorship if somebody just doled out the money like that industry does; but the process obviously is not efficient. It gives no incentive to be efficient. Anybody in the settlements pool who wants to raise salaries, or who wants to do this, or that, can just go ahead and do it.

You get your costs back, and then you get a rate of return. It is so archaic that, maybe at one time at the beginnings of the industry there were some benefits from it, but for this process to persist today in an industry that is so important to the United States, so critical to our society and our commerce, and to the conversion of this country into an information society, is, I think, ludicrous.

Well, they basically want to maintain it. I realize what Mr. Brown is saying: Now that they recognize competition, they want to shift their emphasis to the network, arguing that it must be planned, designed, balanced, configured, and managed as one.

Apparently, they are now willing to say: "We will change the industry from a dictatorship to a cartel."

I don't know if they are inviting me to join it. I haven't received a formal invitation.

But we are not interested in joining A.T. & T.'s cartel. I don't need to go on the dole, and I think basically that is what separations and settlements are.

One other comment. You raised the question about Federal and State jurisdiction, and you have made no mistake about that important issue.

If you give the States jurisdiction, not only over local exchange service—which they have and which you should continue to allow them—but if you also give them jurisdiction over the access of an interexchange carrier to the local telephone company, you will preempt Federal jurisdiction from an area in which its retention is vital because there is no more classical example of a bottleneck as described in the antitrust law than local exchange service.

He who controls local exchange service controls everything else. You can't say that I am free to compete in an interexchange market when you turn the regulation of my whole life, which is the ability to get from my terminal to my customer, over to State jurisdiction.

First of all, I don't think the States have the competence to do it. I think most States are so overwhelmed with regulating water, taxis, and buses, and Lord knows how many other things, they aren't adequately staffed.

You made a comment about Bell's annual report, with their 26 subsidiaries. If the Securities and Exchange Commission was able to enforce the rules, there would be about another 28 PUCs listed there.

Those State regulators cannot regulate the telephone company.

They do not have the ability. They are so overwhelmed. There is a State where one man handled regulation of the Bell Telephone Co., and he told me that the way that he regulated that Bell Telephone Co. was when they came in with a tariff change, they'd take him to lunch and he would routinely approve the change. But, when they took him to lunch and dinner, then he dug in.

Because that was how he could tell they were serious. Bell eventually figured this out. I don't mean to say that the States aren't trying to regulate Bell, but how can they possibly handle it?

There are three States in the United States, to give you an idea, within which specialized carriers compete with the telephone company. One is Oklahoma, another is California, which, I think, has one of the best PUC's, and the third is the State of Texas.

Southern Pacific applied in California and Oklahoma, and they got permission to provide interstate service. You know what the rule is? They can provide it at exactly the same price as the Bell Telephone Co.

What kind of competition is that?

I am in Texas and I can price differently. We were grandfathered in Texas under the PUC. This week, in the State legislature of Texas, Bell has 52 lobbyists registered with the Secretary of State of Texas to lobby in favor of a bill to subject us to regulation.

I have one salesman that I send down there to try to represent us against those 52 in fighting Bell's attempts to get us regulated so that we will have to charge the same as Southwestern Bell.

That is Bell's view of competition, that is the reality of State regulation, and that's what happened.

Mr. Hatfield believes that if you told the States that you believed in competition that would suffice. But, the courts have already told them that, the FCC has already told them that. Take a look at the interconnect industry. There are State PUC's who have said that if you want to have a non-Bell, non-Telco piece of equipment—what the industry calls a foreign attachment, as if the Germans were involved in providing it.

If you want one of those, you have to have two phones. This was as recent as 1977, or something like that. You would have to have one phone for interstate and another, Telco-supplied, for local.

Somebody had to take that to court, and get a declaratory ruling that the States can't do that. No one is arguing about the States regulating local exchange service. It is turning over to the States control over interexchange services—which is what happens if you give them the right to dictate the access charge, terms, conditions—that I am so against. If that happens, Mr. Chairman, you, in effect, are wiping out any competition.

Senator HOLLINGS. I want to come back, let me yield to my colleague, Mr. Chairman.

The CHAIRMAN. I am enjoying this, Mr. Chairman.

Senator HOLLINGS. I was going to say, I must not be taken seriously in this area because I haven't been invited, Charlie Brown, to either lunch or dinner.

Mr. McGOWAN. I think that is the only difference, at A.T. & T. between Mr. Brown and his predecessor.

The CHAIRMAN. Mr. Jones, you would eliminate all of the competition in 10 years. Well, S. 611 would eliminate only half of it. And yet, you complain that S. 611's transition is too abrupt.

How do you reconcile that statement?

Mr. JONES. If that understanding is what I left with you, that is not my intent.

The CHAIRMAN. Why don't you clarify it?

Mr. JONES. The intent would be to reduce the amount of contribution, either in its relative proportion or its absolute proportion.

The question is over time, and I am not limiting myself to a specific 10 years. I said, say 10 years. It may well be that we want to take longer than that to assure that there will not be an adverse impact on the local exchange rates or on the local or Bell companies.

I am not tied to an absolute, nor am I tied to an absolute elimination of the contribution, by any means. I think that would be determined by the marketplace as to how much the interexchange carrier can pay in support.

The CHAIRMAN. Now that you have said that, you have got me more confused than ever, then, because this bill would only eliminate one-half of it in 10 years.

Mr. JONES. I presume you are speaking of the basic exchange maintenance program—I'm sorry.

The CHAIRMAN. And yet, you say, that the transition is too abrupt.

Mr. JONES. If one looks ahead——

The CHAIRMAN. This is the contribution from intercity service to local rates.

Mr. JONES. Yes, sir. And we are talking on the order of about \$5 billion of contribution from the interstate toll rates the end of 1978, and another \$3 or \$4 billion out of intrastate.

If your suggestion is that the basic exchange maintenance program would essentially freeze that level, you are absolutely right—that that would maintain a contribution level at its present state.

However, as you look forward, that contribution is growing on the order of \$700 or \$800 million, so that next year—less any amounts we would get from the access charge provision—this would mean that local exchange rates would have to pick that up in increases in the following year.

And as that continues—that growth is presently continuing each and every year—so there is a substantial amount which would be required each year from exchange rates.

The CHAIRMAN. You indicate the loss of interstate tolls to local exchange under S. 611. And you ignore the fact that under S. 611, the local exchange would be getting access charges for the traffic, including the traffic that they do not get any charge from at the present time, which doesn't contribute to the local rates.

Actually, it seems to me that the local exchange would probably end up better under S. 611 than they would under the current system if it were allowed to continue.

Mr. JONES. I would agree in the first year or so that that could well be the case. They might be offsetting.

However, it would depend upon the amount of growth of access not only for the present industry, but as well the specialized or other common carriers.

I don't want to mislead you to say that it will be totally offsetting in each and every year hereafter. But in year one or two, it might be that it would be at the same level that we are presently budgeting.

The CHAIRMAN. Do you know what the total revenue is from all Bell intercity services that don't pay a contribution under the existing system?

Mr. JONES. I would suspect it is on the order of about \$2 billion. That is the revenue level of those services, private line services, particularly. That includes all private line services, not just foreign exchange and those services which directly access the local network.

The CHAIRMAN. I have heard that it is approximately \$3 billion.

Mr. JONES. I will accept that, subject to check.

The CHAIRMAN. What percent of total intercity traffic is in these services?

Mr. JONES. I would think all intercity. It would be all intercity in the number that you have just quoted.

The CHAIRMAN. Is the percentage growing at the present time?

Mr. JONES. Certainly, the dollar amount is growing, but in proportion to the total business size, I don't think it is growing. It has been around 10 or 12 percent of the business.

My feeling is that it is staying rather stable.

The CHAIRMAN. In any event, if the services have to pay access charge, that would certainly bring a large sum of new money into the local exchange.

Mr. JONES. Yes, it would bring additional amounts of revenue in, no question.

The CHAIRMAN. Might not this enable the MTS rates to decline without raising local rates?

Mr. JONES. It is a possibility, but intercity rates would probably decline as a source of contribution in either its relative or absolute level.

The CHAIRMAN. You support the current separations and settlements as a mechanism which makes it possible for Bell and 1,500 independents to remain financially strong.

Evidently, that view is not shared by all, and particularly Mr. Bahnson. What is your reaction to his testimony? After all, GTE gets a large percent of its revenues at 25 percent in the separation process.

Mr. JONES. I don't think Mr. Bahnson said that. I would hate to put words in his mouth. I think that GTE is a strong financial entity, and I think they are quite dependent upon their toll stream of revenues, both State and interstate and recognize the importance, as we do, of the contribution that is obtained from both State and interstate toll settlements.

The CHAIRMAN. Mr. French, I gather that you recommend that the current separations and settlement procedures be maintained for all intercity toll or MTS traffic.

Mr. FRENCH. Yes, sir. I recognize that there is going to be a gap and you are going to have lowering of rates. But that methodological procedure allows you to make changes to reflect that.

The CHAIRMAN. You list four objectives that any legislation should meet and you recommend how these goals ought to be accomplished.

It seems that three of those four probably are met by S. 611, and in addition, S. 611 meets the objectives of the fourth, but with different mechanism. The access charge, together with the basic exchange maintenance program, are intended to serve the purpose of what is now separations and settlements.

This is capped at a present level of settlements. But the access charge is cost-based and would rise or fall with the cost.

Would you care to comment on that?

Mr. FRENCH. If I understand that provision in the bill correctly, the access mechanism would be administered at the Federal level. That creates bureaucracy problems and is a matter of concern to small companies.

Also, when you cap it, you are not capping it in unit dollars; you are capping it in actual dollars, which turns out to be x number of dollars, and you divide that up, so inflation and growth then will mean that is a percentage of total revenues, it will be a progressively smaller item.

I am not sure that I agree that the bill will in fact maintain support of rural areas.

The CHAIRMAN. Given that this system gives Bell a large amount of bargaining strength vis-a-vis a small company, how do you feel

about Bell's announced goal of eliminating toll contributions to local services over 10 years?

Mr. FRENCH. You mean that they would eliminate the toll support completely? Is that what you are saying?

The CHAIRMAN. They have made the suggestion that they would, they announced that they would have as a goal the elimination of toll contributions to local services over a 10-year period.

Mr. FRENCH. I am now speaking for myself. I think Senator Goldwater comes closer to accomplishing what I would like to see in that regard. Quite frankly, I think if on January 1, I knew toll rates were going to be based on cost, and I was going to lose 40 percent of my revenue, I would rather go to the State commission one time and tell them January 1, I need some \$400,000 and need to increase local rates \$3 per month to cover that and have it over with, one rate case, and transfer the revenue from intercity to local.

The problem with the transition, again, is the small company. It is that with inflation and loss of toll support over a period of time, whether it is 6 years, 10 years, or 15 years, is that the small telephone company is going to always be in a financial bind. When you go to the State rate commission every year and pick up that loss, with the regulatory lag and the entire transition process, the company always will be in a financial bind.

Now maybe politically it would be tough to increase local rates in rural America. But as a company manager, I would have to do it.

The CHAIRMAN. Do you think you would really have that much of a chance?

Mr. FRENCH. If I could go in and say that the Congress has said, "We will have competition, and we are going to lower long distance rates across the country, but there is still going to be no disparity between rural and urban." And that we are losing that revenue and we need to pick up \$3 a month to take the cost of it, that I could sell it to my subscribers.

The CHAIRMAN. That would be an interesting experience to observe from a distance.

Mr. FRENCH. But otherwise, my company is going to be in a financial bind. It took me the last 5 years to get our company back in a sound financial position because of regulatory lag. If you start talking competition and start deloading toll, that means less settlements for us.

Now larger companies can write this off and they can pay. But the small telephone company—we still have to pay the attorneys and the dollars are not there to spread it.

We have to pay the expert witnesses and we still have the lag.

The CHAIRMAN. Mr. McGowan, in testifying last week before the House subcommittee, Charles Brown, chairman of the board of A.T. & T., stated:

I don't think if we get right down to cases that this company has ever abused our situation with respect to offering facilities to anybody that wants them. We have argued over price and we have argued about conditions and connections, but we have not created the so-called bottleneck that people are worried about us creating.

Now from your perspective as a competitor of A.T. & T., have you experienced bottleneck problems?

Mr. McGOWAN. March 16, MCI wrote to Mr. Ellinghaus, the president and chief operating officer of A.T. & T. We decided not to bother Mr. Brown. He was preparing his testimony.

We asked Mr. Ellinghaus for 10 specific interconnection arrangements that the local telephone company is presently providing to Bell's interexchange plant.

We received a letter back on April 3, 1979, which goes on for several pages. I will be happy to submit the entire letter for the record, but let me quote from one sentence:

"We do not believe that * * * the interconnection arrangements you have requested would be in the public interest." A.T. & T. has decided, despite what the court says, despite what the FCC says: "No, we are not going to give you those kinds of interconnection."

I have another letter dated March, in response to MCI's request for broadband interconnection. It comes from a sales manager of business relations at A.T. & T.

"We have no plans to expand these interexchange facility offerings" to include the specialized common carriers.

They refused.

What Mr. Brown said is not so. He made the statement the other day, for example, that he absolutely wants to give facilities to other carriers. He asked, in effect, "Why should we encourage them to build when they can buy our facilities?"

He is not speaking the truth. He turns our requests down, refuses, does not allow it.

A.T. & T. is not a born-again competitor, believe me. They are what they are and I don't see them changing.

The CHAIRMAN. Do you think the provisions of S. 611 are strong enough, then, to handle this bottleneck problem?

Mr. McGOWAN. The advantage I see in S. 611 is that it would create an interexchange corporate structure that can then be removed from A.T. & T. It puts Bell's interexchange operations, at least, in a visible corporate entity that then—if Congress does not want to do it—then the courts can and will remove from A.T. & T.'s control.

It is a good beginning of that.

If it were legislatively possible, or politically possible, to do it now, I would certainly recommend that it be done in this bill. If not, then I certainly think that the structure should be arranged so that it is a visible entity that the courts can extract at the appropriate time.

The CHAIRMAN. By the way—

Mr. McGOWAN. I believe S. 611 does that.

The CHAIRMAN. That was a rather interesting comment, to have them tell you that they didn't believe that that was in the public interest. I didn't realize that they were the ones that made that determination as to what was in the public interest in this day and age.

Mr. McGOWAN. They are the ones. Several years ago, the then chairman of the company spoke to a group of the presidents of the Bell System and said, "We have decided that we are no longer going to accommodate ourselves to Federal competitive policies." They simply said: "We won't pay any attention to what the Federal Government says." I guess they figure that if you have their size,

with 2,000 Bell employees in every congressional district, and 5,000 or 7,000 A.T. & T. stockholders in every congressional district, and if you have been operating that way for so long and you have the kind of record moneys they have and the abilities they have, maybe they felt that they could just ignore the Government.

I don't think they can keep it up much longer. I don't think that they can survive examination of their conduct. But that has been their policy.

The CHAIRMAN. Mr. Bahnson, why do you believe that all costs for traffic in nonsensitive plants should be loaded on the local exchange rates? It seems that some of these costs, directly or indirectly, are associated with provision of intercity service.

Mr. BAHNSON. Yes, they are. We are now entering this area of competitive alternatives. If we are going to have an access charge, they have to be priced at a rate, at a level that will not deter the other carriers from using the full facilities. We have services coming in now where they will go around the local exchange. They will go right to the customer. They won't use telephone company facilities.

I think the marketplace, as Mr. Jones has said, the marketplace is going to determine what that access charge can be. If it is too high, we are going to find our competitors going right around us, going right to the customer.

The CHAIRMAN. Were you trying to indicate you have something to say Mr. Jones?

Mr. JONES. No. If I had a moment, I would like to respond, at least for a moment, to what Mr. McGowan said. I surely would like to state that we do not determine the public interest, by any means.

But what we did indicate in the response to Mr. McGowan was that some of the technical as well as financial issues that he was raising in his request for further facilities, really were questions that were before the FCC in docket 78-72. And we sought expeditious resolution of that docket so that those problems could be aired.

The question really is what price will be paid by the public for that kind of interconnection.

We have not denied interconnection, or access to local facilities. I think he has extended some logic from former FCC orders or from court decisions that I don't really think is totally accurate. We do not determine the public interest. We want that issue aired by the FCC. That is where the issue presently is.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator HOLLINGS. Mr. Hatfield, would you please submit the studies on the impact of deaveraging on the rates?

Mr. HATFIELD. Yes.

[The following information was subsequently received for the record:]

**DEAVERAGING OF INTEREXCHANGE TOLL RATES DUE TO THE INTRODUCTION OF
COMPETITION—PRELIMINARY ESTIMATES, JUNE 1979**

1. INTRODUCTION

Interstate toll telephone (i.e. long distance) rates are averaged on a nationwide basis, that is, a 500 mile long distance call, for example, costs consumers the same amount regardless of whether the call is between two major metropolitan areas or

two small rural communities. Intuitively at least, it would appear that calls between sparsely populated areas would cost more to provide than calls between more densely populated areas. This intuitive result stems directly from (1) the knowledge that calling volumes between the major metropolitan areas are larger than the volumes between rural communities a like distance apart, and (2) the perception that transmission costs decline with volume, i.e. that there are economies of scale in long haul transmission.

Currently, AT&T and their independent telephone company "partners" pool all of their costs of providing interstate long distance service and nationwide uniform rates are established to cover these total costs. The resulting revenues are distributed to the participating carriers so that they recover all of their individual costs. In this way revenues from allegedly low cost, high density routes flow to (or support) high cost, low density routes so that nationwide rate averaging is obtained.

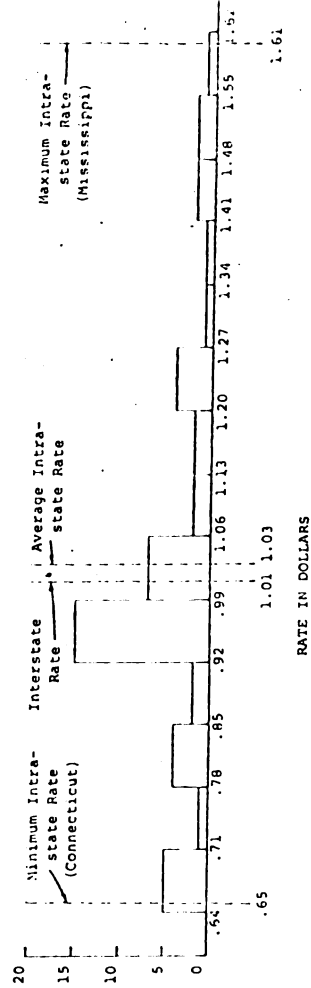
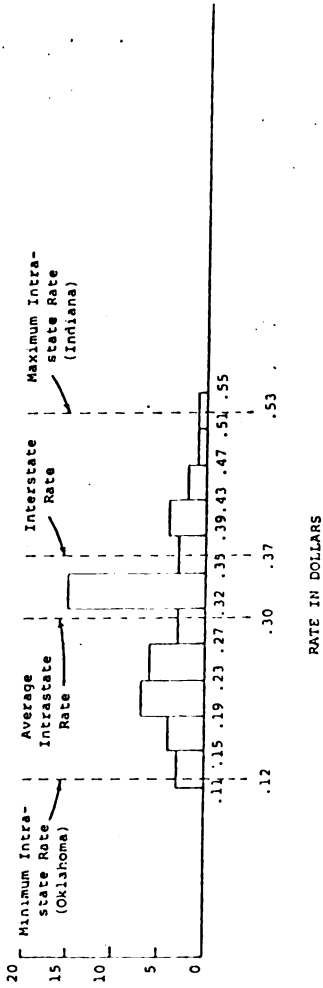
Opponents of the introduction of competition in the interexchange market have argued that the established carriers will be unable to maintain nationwide rate averaging in the face of competition. They argue that nationwide rate averaging is an important social goal and that deaveraging would adversely affect Americans living in rural areas. These arguments have been raised again in conjunction with the introduction in the U.S. Congress of three bills to revise or rewrite the Communications Act of 1934. Although the debate over deaveraging has raged for a number of years, the arguments have been made on intuitive or qualitative grounds, there has been a dearth of hard, quantitative evidence upon which to judge the actual extent of the potential deaveraging.

The purpose of this report is to present preliminary, but quantitative, estimates of the potential deaveraging. Although our analysis is based on a number of critical assumptions, we believe the results are sufficiently reliable to indicate the magnitude of any internal or external subsidy that would be required to limit departures from nationwide rate averaging.

Before turning to our analysis, two points should be made. First, the nationwide averaging we referred to above applies to interstate long distance calls the rates for which are regulated by the Federal Communications Commission. The rates for intrastate long distance calls are regulated by the individual states and these rates vary significantly from state-to-state and between states and the Federal jurisdiction. The rate for a three minute, minimum distance toll call between points entirely within the State of Indiana may—and, in fact, does—differ significantly from the rate for a similar call between points entirely within the State of Oklahoma, for example. Both, in turn, may differ from the rate for a similar call which happens to cross a state boundary. The extent of the variation from state-to-state and between states and the Federal jurisdiction is illustrated by the histograms of Figure 1. This graphically demonstrates that, under the current regulatory arrangements, nationwide rate averaging applies only to interstate calls. Under the three bills now being considered in the Congress, most interexchange service would be put under the jurisdiction of the FCC or its replacement. In other words, the jurisdiction over most of what is now intrastate toll would be shifted from the states to the FCC.¹ In the analysis which follows, we consider the possible deaveraging effects on all interexchange toll rates, not just interstate rates. Consequently, it should be kept in mind that many of these rates are currently "deaveraged" under divided jurisdiction.

¹ The qualification that jurisdiction over most rather than all intrastate toll would be shifted to the FCC stems from provisions in two of the bills. These provisions would allow states to define exchanges that include more than one local exchange network. Since states would retain jurisdiction over intraexchange communications within these newly defined exchanges, it could include jurisdiction over part of what is now state toll.

Rate Week Day Call
--For the Minimum Distance (Top) and for 100 Miles
(Bottom)*



*Source: Long Distance Message Toll Telephone Rates, NARUC, 1979.

**One occurrence for each of the 48 contiguous states except two for Connecticut.

A second and perhaps more important point is that this paper deals only with the potential deaveraging of the interexchange portion of long distance calls. A subscriber placing a toll call makes use of (1) the local (intraexchange) network to enter the long distance (interexchange) network, (2) the interexchange network to get to the distant local exchange, and (3) the distant local exchange to reach the called party. Since local exchanges are used in originating and terminating long distance traffic, a portion of their costs are assigned to the interexchange service. For example, a 25-cent-per-minute charge for a specific long distance call might break down into the equivalent of 7 cents per minute for use of the local exchange at the originating end, 13 cents per minute for use of the interexchange network, and 5 cents per minute for use of the local exchange at the terminating end. Under the existing separations and settlements process all of the costs—i.e., interexchange and the portion of intraexchange assigned to interexchange—are pooled nationwide and averaged. Thus there are two potential forms of deaveraging: (a) an increase in the charges for originating/terminating traffic on those local exchanges where intraexchange costs are high, and (b) an increase in the interexchange charges over low density, high cost routes between remote exchanges.

We believe that the first form of deaveraging—increases and decreases in the costs of originating/terminating long distance calls—can be compensated for by (1) either state or nationwide pooling and redistribution of access charges collected in lieu of current separations and settlements payments, and (2) continued support from REA or similar programs. However, that form of deaveraging is the subject of another analysis and will not be dealt with further in this paper. Instead, the focus will be entirely on the issue of interexchange deaveraging.

The remainder of the paper is divided into three parts. Section 2 contains a very brief and hence greatly simplified description of the existing public switched network. This technical description sets the stage for the actual analysis in Section 3. Finally, Section 4 contains a brief commentary on the policy implications of the results.

2. NETWORK DESCRIPTION

For the purposes of our analysis, the public switched network can be thought of as being composed of five component parts: station equipment, local loops, local central offices, toll connecting trunks, and the intertoll network. The station equipment includes the ordinary telephone or other terminal equipment and the wiring on the customer's premises. The local loop consists, typically, of a pair of copper wires running from the customer's home or business to the local central office serving the area. The local central office or end office can interconnect for local calls any of the individual loops that are connected to it. If a call is destined for a telephone not served by the same central office, then the call is routed via toll connecting trunks into the intertoll network. The intertoll is actually composed of a hierarchy of toll switches and trunks to interconnect them, but they can be lumped together in our analysis. Each local central office homes on, i.e. is served by, a single toll office in the intertoll network. Central offices or end offices are also referred to as Class 5 offices and the toll offices to which they are connected are called toll centers or Class 4 offices. A Class 4 office in the intertoll network serves a number of Class 5 offices in a geographical area. Thus the toll centers provide the first stage of concentration for intertoll traffic originating at end offices and the final stage of distribution for traffic terminating at end offices. If two central offices are served by the same toll center, then a call between would simply be routed via their common toll center. Calls to more distant central offices would be routed through the hierarchy of toll offices in the intertoll network.

3. ANALYSIS

The starting point for this analysis is an estimate of how the costs of providing interstate message toll telephone service can be apportioned on the average, to the various component parts of the network as described above. This estimate is shown in tabular form below and diagrammatically in Figure 2.

	Percent
Originating end:	
Station equipment	10
Local loops	10
Central office	05
Toll connecting trunks	05
Intertoll network (excluding toll connecting trunks)	20
Terminating end:	
Toll connecting trunks	05

	<i>Percent</i>
Terminating end:	
Central office	05
Local loops	10
Station equipment	10
Other (billing, network administration, general overhead, etc.)	20
Total	100

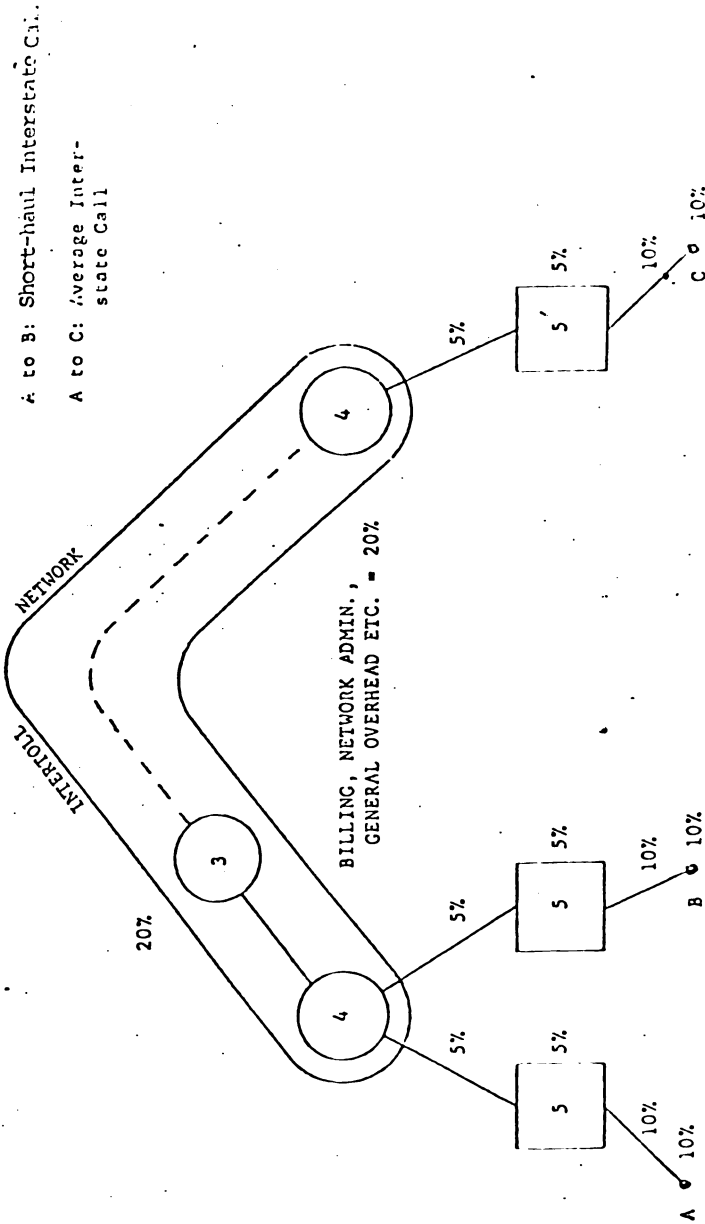


FIGURE 2. NETWORK MODEL -- THE PERCENTAGES SHOWN ARE INDUSTRY'S ROUGH ESTIMATES AS TO HOW THE COST OF PROVIDING INTERSTATE MESSAGE TOLL TELEPHONE CALLS IS ATTRIBUTABLE, ON THE AVERAGE, TO THE VARIOUS FACTORS INDICATED.

The figures are percentages of annualized costs, i.e. the annualized revenues required to provide the service. These figures were obtained from various industry sources and appear consistent with published reports. We believe they are sufficiently accurate for our purposes.

These figures are, of course, averages, and the fear is that with competition, prices will no longer be based on averages, but rather on the underlying, unbundled costs. As noted in the introduction, we are not concerned in this analysis with deaveraging in the state regulated, local exchange portion of the network, i.e. the portion represented by station equipment, local loops, and central offices, since it is assumed that it will be handled by other means. The focus here, then, is on the possible deaveraging in the interexchange portion of the network which consists of toll connecting trunks and the intertoll network portions of the network. This leads to our first key assumption.

We assume that the cost variations in the intertoll network (that is, Class 4 offices and above) are reasonably path and distance independent. This is because decreasing economies with distance tend to be counter-balanced by increasing economies of scale in the growing aggregated volume of traffic that occurs with increased distance. That is, the predominant cost variations in the interexchange network occur in those elements nearest the local exchange-to-intertoll boundary—namely, in the Class 5-to-Class 4 toll connecting trunks. Said another way, once a call reaches Class 4 office, the costs per minute for transiting the remainder of the intertoll network to the terminating Class 4 office are insensitive to the location of the two Class 4 offices or the volume of traffic between them. For example, a call from Sublime, Texas, to Last Chance, Colorado, might travel on much the same portion of the intertoll network as a call from Houston to Denver. The principle disadvantage to Sublime and Last Chance subscribers is in reaching the intertoll network. In short, then, we assume that no significant deaveraging would occur in the intertoll portion of the network, i.e. price variations would stem entirely from the variations in costs of providing toll connecting trunks. We have discussed this assumption with knowledgeable people in the industry and we believe it is a reasonable one for providing preliminary estimates of interexchange deaveraging.

Under rate-of-return regulation, the total cost of providing interstate toll telephone service must equal the total revenues derived from the service. Since revenue (hence cost) figures are readily available, we can easily approximate the total annualized costs of providing Class 5-to-Class 4 toll connecting trunks for all interstate long distance services using the estimated cost percentages given in the table above. However, we are concerned with the possible deaveraging of all interexchange calls and therefore we must estimate the total costs of providing Class 5-to-Class 4 trunks for both interstate and intrastate use. We can compute intrastate toll service costs attributable to these trunks on a usage basis. This is a reasonable assumption because the long-range costs of trunks do vary directly with usage. In other words, we can compute the total cost of providing Class 5-to-Class 4 toll connecting trunks for interstate services and, knowing the total interstate minutes of use, we can compute the equivalent cost per minute. Using this cost and making the assumption that the cost of a minute of intrastate usage of these trunks is the same as the cost of a minute of interstate usage, we can easily compute the total cost of providing toll connecting trunks for intrastate services by simply multiplying by the total intrastate minutes of use. We can then estimate the total annualized costs of providing these Class 5-to-Class 4 toll connecting trunks by simply adding the intrastate and interstate totals. Algebraically this can be expressed as:

Total Cost equals (interstate cost) plus interstate cost divided by interstate min.
of use times (intrastate min. of use)

This can be rewritten as:

Total Cost equals (interstate cost) plus (1 plus intrastate min. of use divided by
interstate min. of use)

Thus, to determine the total annualized cost for toll connecting trunks, we need only multiply the corresponding interstate cost times the sum of one plus the ratio of intrastate to interstate toll usage.

Following this outline, we can now take the next step in our analysis—estimating this total. The 1976 total long distance revenues are as follows:

1976 REVENUES

[In billions of dollars]¹

Service	Intra- plus interstate	Interstate only	Intrastate only
MTS.....	14.2	8.2	6.0
WATS	1.9	1.5	0.4
Total	16.1	9.7	6.4

¹ The first column of figures is from "Statistics of Communications Common Carriers," Federal Communications Commission, 1976, p. 30. Those in the second column are from "The Dilemma of Telecommunications Policy," An Inquiry into the State of Domestic Telecommunications by a Telecommunications Industry Task Force, L. W. Schmidt, Chairman, 1978.

From the earlier table we know that, on the average, 10 percent of the cost of an interstate call goes to supporting the cost of the 4-5 links—5 percent for each of the two 4-5 links involved. Since the total interstate costs/revenues are approximately \$9.7B, the interstate toll costs attributable to the Class 5-to-Class 4 toll connecting trunks are 10 percent of \$9.7B or \$0.97B.

For 1977, data for the industry (Bell and the Independents, i.e. for "all companies") shows that there was 96.87 billion minutes of interstate toll usage and 109.05 billion minutes of intrastate toll usage resulting in an intrastate to interstate usage ratio of 109.05 to 96.87 or 1.13:1.² Using this ratio and the \$0.97B cost figure in the formula produces:

$$\text{Total cost} = (\$0.97\text{B})(1 + 1.13) = \$0.97\text{B} \times 2.13 = \$2.07\text{B}.$$

These are the estimated total annualized costs, both intrastate and interstate, attributable to the Class 4-to-Class 5 toll connecting trunks. It is about 13 percent of the sum of intrastate and interstate distance toll revenues of \$16.1B for 1976 shown in the table.³ Applying this same percentage figure to 1977 total long distance toll revenues of \$18.4B produces \$2.73B as the total annualized revenues needed to support all Class 4-to-Class 5 links in the U.S. for all toll uses in 1977.

Now, if we knew the statistical distribution of costs for all Class 5-to-Class 4 toll connecting trunks in the U.S., we could estimate the impact that these variations might have on the total cost of various toll calls—assuming, as we have, that other cost variations would either be small or could be compensated for in another way. In other words, we could estimate the extent of potential deaveraging, i.e. what percentage of calls would exceed some chosen threshold—say 25 percent above the average. In addition, one could estimate the levels of subsidy (either internal or external) that would be required to prevent the prices of calls using high cost toll connecting trunks from exceeding a similar threshold.

Unfortunately, this statistical cost data for all toll connecting trunks is not available, although we understand special studies are now underway in the industry to develop the needed information. By searching the literature and from discussions with government and industry personnel, we were only able to locate one source of data that we felt could be used for this purpose—albeit with many caveats and reservations. This data is that which was supplied as an industry (i.e. Bell and Independents) response to a request by the State Commission members of a recent Joint Board proceeding.⁴ The response, referred to as JB-68, was to the following request:

"For a selected state prepare and furnish a study showing the cost of providing the terminating toll trunks connecting each exchange end office with its toll center. The trunk costs should include both outside plant and terminal equipment. Study results should include cost per circuit mile, cost per busy hour minutes of use and cost per average hour minutes of use based on actual traffic carried. Summarize the data to show the relationship of exchange size to the cost of providing toll service to

² The intrastate and interstate total long distance toll (MTS/WATS) minutes were supplied by industry representatives.

³ Note that due to short range problems of data availability we are using 1976 cost data but 1977 usage data. This is not a problem, however, because it is the ratio between intrastate and interstate usage that is the determining factor in our formulation and it is fairly stable from year-to-year.

⁴ "Impact of Customer Provision of Terminal Equipment on Jurisdictional Separations," Notice of Inquiry, Proposed Rulemaking and Creation of Federal-State Joint Board, Docket 20981 (FCC 76-1008), 63 FCC 2d. 202 (1976).

the exchange. Select a state having at least 200 telephone exchanges of widely varying geographic and population characteristics."

The final revised data we used was sent to the Joint Board under a cover letter dated April 27, 1978. Copies of the transmittal letter and the JB-68 data are reproduced in Appendix B.

Lacking a better statistical sample of the relevant costs, we must now make a second important assumption. We assume that the Ohio data adequately represents the nationwide variability in the cost (but not necessarily the absolute cost) of carrying toll telephone traffic between Class 4 and Class 5 offices. The JB-68 data includes both the annual cost of providing service between the Class 4 and 5 offices and the relative cost per minute of use. In addition to differences in per-channel cost, the latter figures also reflect differences in trunk utilization efficiency which are, at least in part, attributable to differences in traffic density on trunks serving large and small exchanges. Assuming that modest price changes would not substantially alter toll usage, the cost-per-minute-of-use figures are most closely related to the costs upon which deaveraged prices would be based.

The cost-per-minute-of-use data in JB-68 includes figures based on both average-hour use and busy-hour use. The average-hour data exhibits somewhat greater variability with the per-minute revenue requirement of the highest cost channel being about 18 times larger than the mean and more than 100 times larger than that of the lowest cost channel. The highest busy-hour figure is just over 9.6 times larger than the busy-hour mean and slightly more than 55 times larger than the minimum busy-hour figure (this lesser variability is not surprising since the design capacity of each trunk is based on anticipated busy-hour use). The average-hour data would be appropriate for estimating the impact of price deaveraging if all minutes of use were priced equally. Similarly, the busy-hour data would be appropriate for estimating the impact of price deaveraging if the total revenue requirement were derived exclusively from busy-hour use. Because actual toll rate structures (present and, probably, future) fall somewhere between these two extremes, average-hour and busy-hour data have been used to compute rough upper and lower bounds which are applicable to a variety of multi-level rate structures.

The estimates which have been developed in this preliminary study are based on the hypothesis that differences in the cost of carrying traffic between individual Class 4 and 5 offices would be reflected in geographically deaveraged interexchange toll rates so long as the per-minute cost on the 4-to-5 link remains below a predetermined maximum. The cost of 4-to-5 trunking in excess of this maximum would be covered by a subsidy from a source which could be either internal or external to the telephone industry. The analysis has focused on determining the amount of subsidy required nationwide to absorb 4-to-5 trunking costs above a cost threshold ranging from two to several times the mean cost for all routes. The results of this analysis are tabulated in Table 1. The threshold above which costs would be subsidized is as indicated in the left-hand column of the table. The next two columns indicate the estimated amount of the subsidy and the final two columns indicate the corresponding maximum upward variation in the price of toll service expressed as a percentage increase in the current end-to-end price of an average interstate toll call.

The subsidy estimates were computed by first determining the fraction of the total (busy-hour or average-hour) costs in the Ohio sample which exceed the subsidization threshold. The nationwide subsidy was then estimated by taking the same fraction of the total annualized cost of carrying all toll traffic between all U.S. Class 4 and Class 5 offices. Using either busy-hour or average-hour cost data, for example, approximately 18.3 percent of the total annualized cost of the sampled Ohio toll connecting trunks would have to be subsidized if toll prices included no 4-to-5 trunking costs in excess of two times the mean cost for all routes in the Ohio sample. It was estimated in our earlier calculations that \$2.37B was the total annualized cost of carrying toll traffic between all U.S. Class 4 and 5 offices in 1977. The estimated nationwide subsidy in this case is therefore equal to $0.183 \times \$2.37B = \$434M$ as indicated in the top line of Table 1. A more detailed description of these calculations is presented in Appendix A.

To place the subsidy-limited toll connecting trunk cost variations in proper perspective, the maximum impact on the price of an interstate toll call has been computed using the cost breakdown indicated for a toll call from point A to point C in Figure 2. Approximately 5 percent of the total cost of an average-priced interstate toll call is attributable to trunking between Class 4 and 5 offices at each end of the call. If, for example, the unsubsidized cost of 4-to-5 trunking at both ends of a call could be as high as two times the mean cost, the maximum resulting upward variation in the end-to-end price of the interstate toll call would be an increase of 10 percent above the price of an average-priced interstate toll call. On the average,

however, calls to or from high-cost areas would experience only about one-half of this increase since 4-to-5 trunking costs at the distant end of such calls would average out to a level near the mean cost. Both the 5 percent and 10 percent figures corresponding to these two cases are recorded in the top line of Table 1.

TABLE 1. ESTIMATED INTEREXCHANGE SUBSIDY LEVELS AND A MAXIMUM PRICE VARIATIONS BASED ON DIFFERENCES IN TRUNKING COSTS BETWEEN CLASS 4 AND CLASS 5 OFFICES

(Dollars in millions per year)

Per-min. trunking costs subsidized above	Amount of subsidy with cost based on—		Maximum increase: ¹ 4-5 link costs (percent)	
	Busy hour	Average hour	Maximum 1 end, average on other	Maximum on both ends
2 times mean	434	434	5	10
3 times mean	236	257	10	20
4 times mean	139	167	15	30
5 times mean	100	129	20	40
6 times mean	64	96	25	50
7 times mean	36	66	30	60

¹ End-to-end price of toll call.

Note: The percentages tabulated here are relative to the current average end-to-end price of an interstate MTS call. Costs are assumed to break down between the various component parts of the network as indicated in Figure 2 for the call from point A to point C. The impact of differing 4-to-5 link costs on the end-to-end cost of short-haul toll service (e.g., a call from A to B in Figure 2) is discussed briefly in the text accompanying this table.

Because the cost of 4-to-5 trunking represents a larger fraction of the end-to-end cost of a short-haul toll call, short-haul toll prices will tend to be more sensitive to variations in the unsubsidized cost of carrying toll traffic between Class 4 and 5 offices. For example, the end-to-end cost of a call from point A to point B in Figure 2 is estimated to be roughly 80 percent of the end-to-end cost of an average interstate toll call. On this basis, the impact of deaveraging costs on the 4-to-5 link of a short-haul toll call would be about 1.25 times greater than the figures tabulated in Table 1. There is, however, no assurance that present short-haul toll rates (either state or interstate) accurately reflect the average cost of providing short-haul toll service. The figures developed here should therefore be applied with caution to short-haul toll prices.

4. COMMENTARY AND CONCLUSIONS

In this report, we have presented some very preliminary, quantitative estimates of the potential amount of deaveraging of interexchange toll rates that may result from competition in the provision of long distance telephone services. Because of the lack of needed data, we have had to make several assumptions that are critical to our analysis. Under these assumptions, it would appear that interexchange toll rate deaveraging will not be a significant problem with the introduction of competition, and that if it were so desired (a matter on which we are not now passing judgment) only a modest internal or external subsidy would be required to (1) maintain nationwide rate averaging on long-haul calls, and (2) reduce the current state-to-state and interstate to intrastate toll rate disparity. More specifically, based on busy-hour calculations, we estimate that hypothetical subsidies of \$434M and \$236M would limit the deaveraging on long-haul calls to 10 percent and 20 percent respectively—and this is for the worst-case situation wherein subscribers in high cost locations place all of their calls to other high cost locations. For the more reasonable situation where the subscriber places calls to a random mixture of high and low cost locations, the corresponding subsidy figures for 10 and 20 percent deaveraging are \$236M and \$100M respectively. Even if our assumptions and data are off considerably, we believe the results are sufficiently reliable to give at least a preliminary indication of the situation, including the relatively modest amount of subsidy that might be looked to because of competitive impact; such a subsidy seems a small price to pay for the benefits of full and open competition in the interexchange market.

Although we believe the policy significance of these results is largely self-evident, it might be useful to make some observations about them.

First, the amounts are so small relative to the revenues and profits in the interexchange market that there would be little hardship on the established carriers if they elected to limit deaveraging. In 1978, the Bell System alone had over \$20B in revenues and approximately \$2.5B in profits from the provision of MTS/WATS long distance toll services. By further way of comparison, the total MTS/WATS contribution ("subsidy") to local exchange costs alone amounted to about \$8B in 1978. Thus maintenance of nationwide rate averaging would not appear to put an unreasonable burden on Bell and their independent "partners" nor would it appear to put them at a significant disadvantage relative to the emerging competition—especially if very moderate departures from such averaging were permitted. Moreover, to keep the rate structure simple, and for other reasons, it may make good business sense for the carriers to absorb a modest internal cross subsidy.

Second, even if deaveraging in the plus 10 to plus 20 percent range did occur, it would not be unreasonable to expect added competitive pressures to reduce overall long distance toll rates by similar amounts. If such an overall shift occurs because of added service competition (and added competition in the provision of long-haul equipment because of expanded service market), then everyone could end up better off—even those paying slightly more than the new average. Also, it should be remembered that we are dealing with a "zero-sum game" and that if deaveraging is not limited, rate increases will be offset by rate decreases.

Third, deaveraging pressures could well lead to accelerated development of low-cost microwave or satellite systems for reducing the costs of toll connecting trunks. Under the existing "cost-plus" separations procedures there is less incentive for such developments and valid pricing signals for the introduction of competitive services utilizing more efficient technology are not present.

Fourth, if Congress does not legislatively mandate nationwide rate averaging (and we believe it should not) and if it believes that a residual external subsidy might be necessary as a "safety net," our calculations indicate that the amount required would be relatively small. The bills now do not provide for such a program, and in light of the first three considerations, it might well be the soundest procedure to await developments, obtain timely reports, and act only if warranted by undue or inordinate toll disruptions.

In conclusion, we fully recognize the tentativeness of our results but we hope—and expect—our study to provide an analytical framework and to stimulate more definitive studies by the industry and other interested parties.

APPENDIX A

DESCRIPTION OF JB-68 DATA WE USED ALONG WITH AN EXPLANATION OF HOW WE MADE CALCULATIONS FOR ESTIMATING LEVELS OF SUBSIDY NEEDED TO LIMIT MAXIMUM INTEREXCHANGE TOLL TELEPHONE CALL COSTS

We used the following JB-68 data:

From the "Estimated Cost of Providing Toll Trunks Connecting an Exchange End Office With its Toll Center for Bell & Independents in the State of Ohio," revised:

- (1) Annual cost of providing toll service,
- (2) Cost per busy hour minute of use, and
- (3) Cost per average hour minute of use.

From "Supplemental Data for Joint Board Request No. 68," providing "Number of circuits and mileage for each studied location" we used the number of circuits for each exchange.

The following table shows some intermediate calculations we made both for screening the data and for computing the subsidy levels.

TABLE A1.—TABULATION OF DATA COMPUTED FROM THE JB-68 DATA

Exchange number	Number of minutes of use		Busy hour utilization	Average hour utilization
	Busy hour	Average hour		
1.....	228.200	94.924	0.224	0.093
2.....	132.055	30.168	.157	.036
3.....	141.974	52.767	.148	.055
4.....	188.824	70.810	.350	.131
5.....	184.819	62.339	.154	.052
6.....	199.912	87.594	.196	.086
7.....	446.017	205.855	.323	.149

TABLE A1.—TABULATION OF DATA COMPUTED FROM THE JB-68 DATA—Continued

Exchange number	Number of minutes of use		Busy hour utilization	Average hour utilization
	Busy hour	Average hour		
8.....	402.323	196.883	.447	.219
9.....	449.953	187.697	.288	.120
10.....	345.014	156.168	.442	.200
11.....	198.214	69.135	.194	.068
12.....	190.091	54.255	.176	.050
13.....	396.366	126.117	.264	.084
14.....	249.794	103.466	.134	.056
15.....	218.000	81.945	.173	.065
16.....	259.139	84.850	.160	.052
17.....	493.779	228.189	.358	.165
18.....	397.449	160.041	.170	.068
19.....	742.580	254.600	1.375	.471
20.....	351.855	144.632	.178	.073
21.....	581.542	272.310	.303	.142
22.....	370.114	153.977	.158	.066
23.....	253.699	90.091	.423	.150
24.....	1,135.524	560.193	.321	.158
25.....	408.511	180.256	.309	.137
26.....	506.067	191.486	.187	.071
27.....	260.377	90.173	.289	.100
28.....	1,200.685	514.580	.465	.199
29.....	911.517	374.787	.287	.118
30.....	2,300.913	777.775	1.598	.540
31.....	1,309.301	672.351	.642	.330
32.....	775.379	296.126	.264	.101
33.....	2,294.795	695.394	.503	.152
34.....	1,635.855	787.953	.384	.185
35.....	6,185.479	2,132.931	.551	.190
36.....	571.450	256.060	.173	.078
37.....	1,376.291	694.825	.364	.184
38.....	992.586	399.030	.276	.111
39.....	4,771.760	1,707.330	.476	.170
40.....	3,001.957	1,500.976	.428	.214
41.....	3,049.706	1,377.290	.541	.244
42.....	1,872.456	859.492	.254	.116
43.....	4,794.726	2,130.989	.601	.267
44.....	5,648.493	1,793.175	.514	.163
45.....	2,099.460	1,180.949	.229	.129
46.....	7,098.425	3,190.303	.623	.280
47.....	5,430.479	2,555.529	.495	.233
48.....	6,705.479	2,980.222	.484	.215
49.....	8,518.453	3,913.892	.465	.214

* No data for exchanges 19 and 30 were used because of these inexplicably high utilizations.

Subsidy levels required to limit Class 5-to-Class 4 office trunk call costs to no more than a few times the mean cost of providing all 4-5 links for all uses were based both on busy hour and on average hour per-minute call costs. From the JB-68 data (Appendix B) we first computed the mean cost for both the busy hour and average hour minutes of use. Then for multiples of these mean costs we determined those exchanges whose per-minute costs were above these values. For each of these exchanges we determined the amount of subsidy needed to limit the cost to the multiple of the mean cost being considered. We then totaled the required subsidies for all exchanges and divided this by the total of the costs for all exchanges. This gives the fraction of the total annual cost of providing the Class 5-to-Class 4 office trunks for all uses in the 47 exchange Ohio sample that the subsidy would support.

This fraction was then assumed to apply to the universe of all toll connecting trunks. By applying this fraction to the \$2.37B total annualized revenues (computed in Section 3 of the main body of this report) needed to support all Class 4-to-Class 5 links in the United States for all toll uses, in 1977, the required subsidy level was computed.

As an example of our calculations, consider the busy hour approach, and, for simplicity, the case where costs above seven times the mean cost for all calls would be subsidized. The following tabulation gives the basic data:

Exchange number	Cost as a factor times the mean cost	Annual cost of providing toll service	Needed subsidy
2	9.645	\$21,208	\$5,816
15	9.228	33,499	8,088
18	7.935	52,515	6,188
Total			20,092

The total annual cost of providing toll service for all 47 sample exchanges is \$1,319,390. The needed subsidy (\$20,092) is 1.523 percent of this. Applying this percentage, from this 1976 data, to the \$2.37B total annualized revenues needed to support all Class 4-to-Class 5 links in the United States for all toll uses, in 1977, gives \$36M as the overall nationwide subsidy level required. This is one of the entries in Table 1 of the main body of this report. All other calculations—both for the busy hour and average hour approaches—were exactly analogous.

APPENDIX B

AMERICAN TELEPHONE & TELEGRAPH CO.

New York, N.Y., April 24, 1978.

Honorable Commissioner WILLIAM SYMONS, Jr.,
Public Utilities Commission, State of California, California State Building, San Francisco, Calif.

DEAR COMMISSIONER SYMONS: Attached are revised pages of our response to data request JB-68, which were previously furnished you on February 1, 1978. Lines 19, 28, 30, 33 and 34 have been changed.

Very truly yours,

CHARLES R. JONES.

ESTIMATED COST OF PROVIDING TOLL TRUNKS CONNECTING AN EXCHANGE END OFFICE WITH ITS TOLL CENTER FOR BELL AND INDEPENDENTS IN THE STATE OF OHIO

[1976 = 9 percent]

Exchange number	(A)	Cost of toll trunks including circuit equipment			
		(B)	(C)	(D)	(E)
1	122	\$8,246	\$39.00	\$0.099	\$0.238
2	138	21,208	47.64	.440	1.926
3	153	11,556	36.00	.223	.600
4	173	4,342	49.00	.063	.168
5	219	11,468	58.51	.170	.504
6	240	9,048	35.00	.124	.283
7	243	8,791	41.00	.054	.117
8	248	13,510	63.00	.092	.188
9	342	11,989	34.00	.073	.175
10	347	5,415	41.00	.043	.095
11	375	11,431	149.42	.158	.453
12	384	19,011	41.42	.274	.960
13	390	7,089	39.00	.049	.154
14	470	28,173	33.78	.309	.746
15	473	33,499	101.60	.421	1.120
16	484	10,499	24.46	.111	.339
17	521	10,994	43.00	.061	.132
18	528	52,515	56.34	.362	.899

ESTIMATED COST OF PROVIDING TOLL TRUNKS CONNECTING AN EXCHANGE END OFFICE WITH ITS TOLL CENTER FOR BELL AND INDEPENDENTS IN THE STATE OF OHIO—Continued

[1976 = 9 percent]

Exchange number	Cost of toll trunks including circuit equipment				
	(A)	(B)	(C)	(D)	(E)
19.....	536	6,505	30.22	.024	.070
20.....	577	21,961	46.54	.171	.416
21.....	745	25,047	77.00	.118	.252
22.....	765	14,725	47.79	.109	.262
23.....	766	11,575	66.14	.125	.352
24.....	845	61,341	55.00	.148	.300
25.....	952	25,199	60.93	.169	.383
26.....	1,028	12,930	19.55	.070	.185
27.....	1,125	7,603	34.25	.080	.231
28.....	1,233	42,072	43.10	.096	.224
29.....	1,529	26,949	25.31	.081	.197
30.....	1,635	20,156	27.63	.024	.071
31.....	1,650	9,080	23.00	.019	.037
32.....	1,758	21,509	15.24	.076	.199
33.....	1,849	25,128	17.00	.030	.099
34.....	1,954	54,932	43.32	.092	.191
35.....	2,103	22,577	38.45	.010	.029
36.....	2,127	34,207	25.18	.164	.366
37.....	2,356	26,122	36.00	.052	.103
38.....	2,978	57,967	41.82	.160	.398
39.....	3,697	67,926	43.83	.039	.109
40.....	4,231	23,010	45.00	.021	.042
41.....	5,198	15,584	81.00	.014	.031
42.....	7,475	38,273	64.69	.056	.122
43.....	8,589	70,003	41.12	.040	.090
44.....	9,077	41,234	56.59	.020	.063
45.....	9,566	75,864	39.35	.099	.176
46.....	11,740	103,637	65.56	.040	.089
47.....	14,133	31,714	31.74	.016	.034
48.....	14,505	19,580	26.00	.008	.018
49.....	25,184	52,857	31.74	.017	.037

(A) Number of working lines in studied exchange.

(B) Annual cost of providing toll service.

(C) Annual cost per circuit mile.

(D) Cost per busy hour minute of use.

(E) Cost per average hour (total day minutes divided by 24 hours) minutes of use.

NOTE: Bell exchanges were studied 14 hours and expanded to reflect 24 hours.

SUPPLEMENTAL DATA FOR JOINT BOARD REQUEST NO. 68—NUMBER OF CIRCUITS AND MILEAGE FOR EACH STUDIED LOCATION

Exchange number	Circuit miles	Number of circuits	Average route miles
1.....	209.1	17	12.3
2.....	445.2	14	31.8
3.....	318.9	16	19.9
4.....	87.8	9	9.8
5.....	196.0	20	9.8
6.....	260.3	17	15.3
7.....	216.4	23	9.4
8.....	212.9	15	14.2
9.....	347.6	26	13.4
10.....	130.8	13	10.1
11.....	76.5	17	4.5

SUPPLEMENTAL DATA FOR JOINT BOARD REQUEST NO. 68—NUMBER OF CIRCUITS AND MILEAGE FOR EACH STUDIED LOCATION—Continued

Exchange number	Circuit miles	Number of circuits	Average route miles
12	459.0	18	25.5
13	183.0	25	7.3
14	833.9	31	26.9
15	329.7	21	15.7
16	429.3	27	15.9
17	257.1	23	11.2
18	932.1	39	23.9
19	215.3	9	23.9
20	471.9	33	14.3
21	324.5	32	10.2
22	308.1	39	7.9
23	175.0	10	17.5
24	1,118.1	59	19.0
25	413.6	22	18.8
26	661.5	45	14.7
27	222.0	15	14.8
28	976.1	43	22.7
29	1,064.8	53	20.1
30	729.6	24	30.4
31	394.1	34	11.6
32	1,411.2	49	28.8
33	1,478.2	76	19.5
34	1,268.1	71	17.9
35	587.2	187	3.1
36	1,358.5	55	24.7
37	718.8	63	11.4
38	1,336.0	60	23.1
39	1,549.8	167	9.3
40	509.0	117	4.4
41	191.8	94	2.0
42	591.6	123	4.8
43	1,702.4	133	12.8
44	728.6	183	4.0
45	1,927.8	153	12.6
46	1,580.8	190	8.2
47	999.2	183	5.5
48	753.1	231	3.3
49	1,665.3	305	5.5

Senator WARNER. Mr. French, would you like to comment on the observations made by Mr. McGowan? Or do you feel that you are sufficiently on the record?

Mr. FRENCH. I would prefer to limit my comments to how the bills will affect rural America. I want to see that rural America continues to receive telephone services at reasonable rates on a nondiscriminatory basis. I think that is important.

Senator WARNER. As a follow-on, I am interested in the ability of rural America to participate, subject to capital limitations, in the new technology.

Specifically, do you think that we should include in this proposed legislation provisions to enable rural America to receive the new technology, or do you feel rural America is adequately provided for now?

Mr. FRENCH. I think you should, but through the REA.

Senator WARNER. I want to address the question of whether the REA loan program should include provisions for new equipment in the rural systems?

Mr. FRENCH. The problem that I see is that with the CATV facilities or the broadband facilities, is how do you economically furnish that?

It is pretty clear, based on information available, that economically there should be one service provider. Rural America just can't support two. Then the problem you have is who is going to do it? Will it be the CATV people or the telephone company?

At the present time, the telephone companies are providing the broadband facilities. You have CATV companies that are serving the town, or the doughnut. They are serving the inside—the core—but not rural America.

So the basic problem for Congress is how are you going to make those funds available to economically get the job and still not disrupt telephone services now being furnished.

Senator WARNER. What about the utilization of computers? Again, is it a question of capital requirements?

Mr. FRENCH. No. We have computers.

Senator WARNER. How widespread is their use in rural systems?

Mr. FRENCH. If you are talking about telephone service, we use them for switching. We also have a computer that we use for billing.

I think that the problem is that we are not able sometimes to utilize computers to their maximum capabilities. We used ours to put out the tax bills for the county. The FCC said that we couldn't do that. We had to quit. They are not allowing the telephone companies to use the resources that are available to serve and benefit their community.

Senator WARNER. Do any other members of the panel care to comment on Mr. French's observations?

[No response.]

Senator WARNER. Thank you, Mr. Chairman.

Senator HOLLINGS. Let me ask, the competition between A.T. & T. and MCI, of course, with your specialist service, Mr. McGowan, and then you, Mr. Jones, you compete with CCSA and FX. Is it your complaint, Mr. McGowan, that they are not operating that competition in the wholly owned subsidiary?

Is that your position?

Mr. MCGOWAN. My complaint primarily relates to our inability to secure interconnection from the local telephone companies controlled by A.T. & T.

MCI offers long-distance telephone service of a number of types. We have some that are directly competitive with A.T. & T. My fundamental point is that A.T. & T. competes with us in the long-distance market, and then uses its control over the local exchange companies to put us at a competitive disadvantage, technically, operationally, and economically.

Senator HOLLINGS. And yet, you are competing and succeeding. Your comment Mr. Jones?

Mr. JONES. I think we are competing head to head for both message telephone service, and private line service, including that which is called FX and CCSA.

Senator HOLLINGS. Mr. McGowan, in March you stated to the CWA, A.T. & T. works for the local telephone company with full testing maintenance, transparent interface. MCI is not permitted such an arrangement. A.T. & T. networks obviously are working four wire trunks of any switch. MCI is not permitted such an arrangement.

A.T. & T. interconnection is with the local exchange on a broad band interface; and MCI is not permitted such an arrangement.

What are the advantages of those interconnection arrangements you seek, and why are they denied?

Mr. MCGOWAN. Let's take each one for a very short comment. The type of testing and maintenance that local telephone companies will do with Bell would allow them to go on an end-to-end testing. That is, they will go from their test board through the system, thereby being able to take a look at the entire circuit, to be able to identify where the problem is whether in the local connection, or the local switch, or a long haul switch, or wherever.

They tell us: "We have given you a facility and we have nothing to do with it. We will not jointly test that with you." Therefore, MCI has to try to identify out the problem on its own, and we are at a disadvantage because we are not allowed into their buildings to be able to do end-to-end testing, which they refuse to do.

End-to-end testing is a routine, done in the entire telephone industry with the exception of us and a couple of the other specialized carriers. Their refusal puts us at a disadvantage in spotting trouble. Also, when they deal with the long distance part of their network, they deal with it on what is known as a four-wire basis.

The telephone from your home to the local central office is two wires. You have two wires carrying the conversation in both directions. Once you reach a central office, from there you go on four-wire, which means the circuit that you are speaking on is entirely different from the circuit that the other person in the conversation is using to speak to you. They are kept separate.

The impact is on the quality of service. The two-wire circuit can hold the conversation only for a very short distance. After that, the quality starts fading very badly. You have trouble in quality. It is completely acceptable to be two-wire from your home to the local central office. But on long distance, it is not.

By forcing us to have literally the same connection as you receive in your home—and we are trying to put in 3,000-mile conversations on that line—you get deteriorated quality. It doesn't work as well.

In addition, in one of our terminals in Chicago, for example, where we have three terminals right downtown, if someone calls out to O'Hare Airport, which is a good distance out, the quality is very poor because A.T. & T. is forcing us on a two-wire basis rather than on a four-wire interconnection.

They literally put us at an economic and technical, as in that case, and operational disadvantage by refusing to provide that kind of connection. Yet, at the same time, the local telephone company, whether it is Bell, or not, deals with any established intercity carrier on a four-wire basis. And they refuse to do that with us. They do not recognize us as deserving that.

It doesn't have anything whatsoever to do with the comment I heard before regarding how much are you going to pay for it? If they want to argue about how much we should pay for these connections, why don't we have a meeting and determine it?

They don't argue about how much they should charge us for that. They just say no. What they do say is: "It is not in the public interest. We will not give it to you."

The dispute is not about money. They are trying to disguise their absolute refusal. If they wanted to say they would charge more, let them say charge more. If it costs more, they should charge us more.

But that fundamentally doesn't mean they should discriminate.

Mr. FRENCH. Part of the problem in rural America is the competition between Bell and MCI. We would like to be able to compete. We are not in a private-line business. We are in local service and message toll. This is my reading of the concept of "volume discount," an average toll rate.

If we can participate on that basis, then we will be able to participate in that growth, rather than have it diverted over the private-line services.

Senator HOLLINGS. Mr. Jones, you said the percent of long-distance revenue from noncontributing services has been stable; that 10 percent or so—has some proportion of traffic carried by the services of all long-distance traffic also have been stable, or has that grown?

Mr. JONES. I would suspect that the proportion of traffic has probably grown, although the traffic is not specifically measured over the private-line services. But if you look at the growth of circuits as some indication, certainly the private-line circuit network has grown substantially. These facilities are generally dedicated to specific customers and therefore it is a less efficient arrangement than is the commonly used intercity network that provides MTS and WATS.

Senator HOLLINGS. A.T. & T. has proposed to the FCC that the contribution by long-distance traffic for local rates be reduced and ultimately eliminated. If that is correct, why?

Mr. JONES. Once again, I think, as Mr. Bahnson has said, the marketplace will ultimately determine what kind of a contribution or contribution level can be afforded by the intercity carrier. And what we suggested was a transition period.

We did not explicitly say "elimination, period." It may be that the marketplace will demand eventual elimination. We are just not sure of that at this point in time.

Senator HOLLINGS. Mr. Bahnson, Mr. Jones has a great deal of trouble with S. 611 and S. 622, the exchange areas. You have extensive local exchanges. Do you have similar problems with the definition?

Mr. BAHNSON. I have a problem with relating it to the—for example, it could take in—

Senator HOLLINGS. The statistical metropolitan area?

Mr. BAHNSON. We serve Hawaii. Honolulu is the area. So the whole State of Hawaii could be one exchange under that definition. That does give me a problem; yes, sir.

Senator HOLLINGS. You think it should be smaller than that?

Mr. BAHNSON. I would think so.

Senator HOLLINGS. Mr. Jones, do you have a suggestion?

Mr. JONES. As I said, I think the SMSA may have some value in determining the outer bounds of what should be a total exchange area. But I think that we have to recognize that there are a variety of configurations out there that perhaps have developed over time. The exchange definition is one that has come from a technological source. But I think, as well, it is defined by customer calling habits and desire's, and the response by the State commissions in providing those calling patterns and calling arrangements.

I am not prohibiting the use of SMSA. I just have some reservations about it as a single definition. I think, as Mr. Marshall said in his testimony before you, that we have to look at a transitional process to adjust these to reflect what it is the customer really is looking for.

Senator HOLLINGS. Mr. Hatfield, how could a single ceiling for access charge be settled on a national basis without either harming some carriers whose costs are abnormally high, or setting the ceilings at such a high level that the ceiling would be meaningless?

Mr. HATFIELD. That is not our position. Our position is that the ceiling should be set on a State-by-State basis, reflecting the contributions that are made today.

Senator HOLLINGS. Elaborate on that in the light of what Mr. McGowan said as to the model network he described on the State-by-State basis.

Mr. HATFIELD. I think our position is fairly clear, that we feel that if the Congress passes a law that says the States shall not discriminate, that interconnection is mandatory, and so forth, that the States will obey that law.

If they don't, then there are remedies in the court. We think the legislation should mandate that very, very strongly. I understand—

Senator HOLLINGS. Mr. McGowan?

Mr. MCGOWAN. Even if they did, basically it could be structured so that Bell is taking it from one pocket and putting it in the other. That doesn't help MCI at all. As a matter of fact, Bell could have a tremendous amount of funds flow from their so-called interexchange system to their local telephone company, because all of the cities in which there is a major wave of competition are served by the Bell system.

As long as A.T. & T. controls the local exchange carrier and the interexchange carrier, it can play around with those funds continually until competition is crippled or eliminated and then decide how it really wants those funds allocated.

The States can neither regulate nor control this process. I don't think they have the capability. I don't think you can mandate capability, or willingness, or competence, or staff, or support. I don't think it is possible. When it comes to dealing in the regulatory atmosphere, I gave up believing in the tooth fairy a long time ago.

Senator HOLLINGS. Mr. Jones?

Mr. JONES. I guess I would say that, along with Mr. Hatfield, I think that there would be a counterbalancing on the level of the access charge. If it is too high, it is going to prohibit the use of the

local exchange. If it is too low, then it will be perhaps not providing enough contribution.

I think really what will determine the amount of contribution again is how much Mr. McGowan and I can pay from the interexchange service that we provide.

Senator HOLLINGS. Very good.

I think this has been one of the most helpful panels we have had.

You say, Mr. Jones, that there is one step in attempting to maintain universal service. The Bell System is moving to measure local service. How does this jibe with the concern over the exchange definition, not applying to—not taking the calling habits into account?

Mr. JONES. I think we would, under measured service. I guess the dispute might be over whether you want to be charged for each individual unit of use. I think the measured service concept at least would still reflect the calling areas and the time of day. It has a potential for a great deal of variation.

I think in some cases, however, there are specific State legislatures which are legislating absolutely against that. The distinguished Senator from Virginia has a legislature which has just passed some legislation in that regard. It forecloses an option to the local telephone companies.

Senator HOLLINGS. Well, I want to thank each of you on the panel. We appreciate it very much. Does anyone wish to comment further?

[No response.]

Senator HOLLINGS. Thank you very much.

We will be back at 2 o'clock.

[Whereupon, at 11:40 a.m., the hearing was recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

Senator HOLLINGS. All right. Good afternoon.

The hearings scheduled for Tuesday, May 1, will be held in room 235, instead of 6226 as previously announced.

Again, with this panel we have a time limitation of 10 minutes for the opening statements, so we can then turn around and come back for discussion and questioning by committee members.

This yellow light shows when you have 1 minute remaining, and the red light is when your time has expired.

We have a panel of Kati Sasseville, telecommunications office, State of Minnesota; Weldon W. Case, United States Independent Telephone Association; Raymond Dujack, Federal Communications Commission; Milton Stewart of the Cornelia Telephone Co. of Cornelia, Ga.

We will start with you first, Mr. Dujack.

STATEMENTS OF KATI SASSEVILLE, TELECOMMUNICATIONS OFFICE, STATE OF MINNESOTA, MINNEAPOLIS, MINN.; WELDON W. CASE, UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION; RAYMOND DUJACK, FEDERAL COMMUNICATIONS COMMISSION; AND MILTON STEWART, CORNELIA TELEPHONE CO., CORNELIA, GA.

Mr. DUJACK. Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear before you to offer some of my comments on the Basic Exchange Maintenance program as set forth in section 222 of S. 611.

I am with the Common Carrier Bureau of the FCC, where I am Chief of the Cost Analysis Branch in the Economics Division. Our charter includes, among other things, the responsibility for determining the compatibility of existing separations and settlements procedures with the competitive environment which has already been established by the Commission; namely in the provision of terminal equipment and in specialized common carrier service.

My comments today represent a personal viewpoint, as a civil servant, and do not necessarily reflect the views of the Commission or my Bureau.

I have prepared my thoughts on two levels of abstraction. At the first level, given the mechanism of the BEMP as I perceive it, I would like to comment on the broad public interest implications of BEMP, on the effects upon consumers—from the point of view of quality—and on whether BEMP makes good economic sense.

At the second level, given BEMP as it is currently defined, I would like to comment on the practical aspects of implementing such a program.

I would then like to offer a few suggestions to the subcommittee which I believe might enhance this proposed legislation and which might make life easier for those of us who would have to work under it.

I would like now to state very briefly my perception of the mechanism of the BEMP and then, given that perception, to comment.

Section 222 would abolish the existing toll settlements procedure, whereby local operating companies derive toll service revenues from the inter- and intrastate revenue pools solely on the basis of costs derived by jurisdictional separation procedures.

Under current procedures, the more that common plant costs can be allocated to the provision of toll service, the greater will be the toll service revenue withdrawn from the pool by a given local company.

Under our existing statute, a Federal-State Joint Board may be convened to change these allocative procedures, either to increase or decrease the flow of funds from the pool to the LOC. And in 1971, in order to allow LOCS to keep a lid upon the rates charged for exchange and intrastate toll service, a Joint Board did, indeed, act to increase the flow of pool funds to the local companies.

At that time the subscriber-line-use factor, SLU, which was used to allocate certain exchange costs to toll, was intentionally replaced by SPF, which essentially tripled the amount of exchange subscriber plant costs which could be transferred to toll service.

Now, under the new legislation, the existing procedure for distribution of toll revenues would be replaced by one which would reimburse the local company under a procedure involving two separate payments.

The first payment comes from those interexchange carriers who use exchange facilities, who will reimburse local companies directly through an access charge. Such access charges will be based solely on actual costs—which I interpret to mean costs which can be assigned either directly, or by relative use, and which will not contain the subsidies inherent in the SPF factor.

The component of toll service revenue which was formerly derived from the use of subscriber plant factor—and this is the subsidy component—will be paid out under the jurisdiction of a permanent Federal-State Joint Board. These funds will come from an exchange maintenance fund which will be created annually from the contributions of those interexchange carriers which use exchange facilities.

This EMF will remain fixed in time. So will the payments to the local company; and the size of the fund will be determined once and for all by examining total toll service payouts during the year immediately preceding enactment of the bill. Disbursements to the local companies will be in accordance with that amount of toll service revenue received which was attributable to subsidies from subscriber plant factors.

Assuming that what I have said is an accurate representation of what BEMP is all about and how it works, I would like to comment, first of all, upon some of the philosophical foundations of BEMP as I understand them in section 222. I would then like to comment on what some of the effects might be.

Implicit in the manner in which the BEMP is set up and administered is the assumption that the subsidies flowing from the toll pool, which are generated by the existing separations procedures, are economically inefficient and place an unfair burden upon the toll service user and do not provide sufficient incentive to the operator of local exchange service to reduce charges.

Hence, exchange access charges would be based on actual costs. The implementation of such a philosophy would result in an immediate decline in toll revenue to a local company by the amount of the subsidy generated by the SPF, but the payout from the fixed EMF will, in the first year, make up for the shortfall in revenue.

As the real value of the fund declines with time, due to inflationary effects, local companies will have economic impetus to stabilize profits by: One, reducing costs through operating efficiencies and new technology and two, stimulating interexchange service activity.

Philosophically, I think this concept makes good economic sense, and it could, on a nationwide basis for toll and exchange users alike, result in better communications service and lower costs.

We must, on the other hand, be prepared to deal with departures from the theoretical model.

I would like to look at a possible scenario resulting from the application of BEMP. In the first year, the combination of access fee revenues and EMF payouts should not cause any serious loss in total operating revenues to any local company. There should, there-

fore, be no discernible upward rate pressures upon local exchange service.

However, if access fee revenues do not increase at a rate greater than the decline in the EMF, upward rate pressures would appear. And if this were to occur, gentlemen, it is by no means certain that cost-cutting fixes or the introduction of new technology will, in all cases, prevent an increase in local exchange rates.

The subcommittee should be aware, therefore, that in isolated cases, unrectifiable upward rate pressures may appear, and the subcommittee may wish to address this in its legislation. I would suggest some language be added to the bill which would state the congressional policy stance with respect to the possibility of upward rate pressures upon local exchange services and the possibility of any remedial action.

I would like now to talk about the practicability of the procedures which would be necessary to implement BEMP and also to indicate some areas where we feel that more explicit guidance from the new legislation might be desirable. First, I will address issues associated with setting of access charges, and then those issues associated with the administration of EMF.

And, Mr. Chairman, since I will go over my allotted time if I cover all of these issues, I will hit just a few key ones and the rest is in my written testimony.

Senator HOLLINGS. Very well.

Mr. DUJACK. A key issue related to the setting of access charges is: What type of cost method is contemplated?

It seems clear that some type of exchange/interexchange cost separations procedure will be necessary to determine the costs of interexchange use of exchange facilities. And we ask, will these be relative use principles, similar to those embodied in the 1971 NARUC/FCC Separations Manual, or will they be cost-causational principles, or something else?

And, if these principles are not to be defined in the amendments, what will be the discretionary power of the Commission to determine them?

I would like next to address some practical problems having to do with the computation and distribution of the exchange maintenance fund.

The size of this pool will be that amount representing the subsidy in excess of actual costs, due to the use of the SPF factor, paid out in the year prior to the enactment of legislation.

In order to determine this amount, it will be necessary to examine the records of approximately 500 companies which use cost separation studies as a basis for obtaining toll settlement revenues. And, using this information, it will then be necessary to compute the toll service revenue which would have been obtained had SLU been used instead in the allocation of the exchange plant.

And now surfaces a dilemma which must be dealt with. I am not sure it would be logically feasible for a joint board to perform this task on its own. On the other hand, if the carriers were to do it, they might rightly claim that they should be allowed to flow through to their customers the cost of performing additional studies. And, if the carriers do perform these studies exclusively, the

joint board could be faced with an equally formidable monitoring task.

Given these potential problems, I would like to comment on the role of the joint board.

The responsibilities assigned to the joint board must be carefully balanced with the costs of carrying out these responsibilities.

There are two very big tasks that have to be done on a one-time basis. I just alluded to those.

Meanwhile, on a continuing basis, the joint board must periodically determine who pays what into the pool, and periodically disburse payments to the 1,500 companies.

Again, as I said before, it would be useful if the subcommittee were to investigate the feasibility of a joint board delegating some of its responsibilities to the industry.

And now my bottom line. I would like to conclude by saying that the basic concept of BEMP is sound, and that it meshes intelligently with the overall concept of the proposed legislation.

However, because of the unpredictability of certain economic effects, and of potential implementation problems which may not appear until we get hands-on experience, the Commission and the joint board should be given statutory discretion to alter some of the rather specific formulations set forth, and also, in addition, to elucidate some of the more general principles, in order that we achieve the intent of Congress in an economic and efficient manner.

That concludes my remarks.

[The statement follows:]

STATEMENT OF **RAYMOND L. DUJACK**, CHIEF, COST ANALYSIS BRANCH, ECONOMICS DIVISION, FEDERAL COMMUNICATIONS COMMISSION

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to appear before you to offer some of my comments on the Basic Exchange Maintenance Program (BEMP) as set forth in Section 222 of Senate Bill 611. I am with the Common Carrier Bureau of the FCC, where I am the Chief of the Cost Analysis Branch in the Economics Division. Our charter includes, among other things, the responsibility for determining the compatibility of existing separations and settlements procedures with the competitive environment which has already been established by the Commission in the provision of terminal equipment and in Specialized Common Carrier Service.

My comments today represent a personal viewpoint, as a civil servant, and do not necessarily reflect the views of the Commission. I have prepared my thoughts on two levels of abstraction: First, given the mechanism of the BEMP as I perceive it, I would like to comment on the broad public interest implications of BEMP, on the effects upon consumers—from the point of view of cost and quality—and on whether BEMP makes good economic sense.

Second, given BEMP as it is currently defined, I would like to comment upon the practical aspects of implementing such a program. I would then like to offer a few suggestions to this Subcommittee which I believe might enhance this legislation and which might make life easier for those of us who would have to work under it.

I would like now to state very briefly my preception of the mechanism of the BEMP, and then, given that perception, to comment.

Section 222 would abolish the existing toll settlements procedure—whereby local operating companies (LOCs) derive toll service revenues from an inter- and intra-state revenue pool on the basis of jurisdictional separations procedures.

Under current procedure, the more common plant costs can be allocated to the provision of toll service, the greater will be the toll service revenue withdrawn from the pool by a given LOC. Under our existing statute a Federal-State Joint Board may be convened to change these allocative procedures—either to increase or to decrease the flow of funds from the pool to the LOC. And in 1971, in order to allow LOCs to keep a lid upon the rates charged for exchange and intra-state toll service, a Joint Board did, indeed, act to increase the flow of pool funds to the LOCs. At that

time, the subscriber line use factor (SLU) was intentionally replaced by a subscriber plant factor (SPF) which essentially tripled the amount of exchange subscriber plant costs which could be transferred to toll service.

Under the new legislation, the existing procedure for the distribution of toll revenues would be replaced by one which reimbursed the LOC under a procedure involving two separate payments:

(1) Those interexchange carriers who use exchange facilities will reimburse LOC's directly through an access charge. This charge will be subject to regulation by the FCC. Such access charges will be based solely on "actual costs" (direct assignment and relative use as measured by the SLU factor) and will not contain the subsidies inherent in the use of SPF.

(2) The component of toll service revenue which was formerly derived from the use of SPF—the subsidy component—will be paid out under the jurisdiction of a permanent Federal-State Joint Board. These funds will come from an exchange maintenance fund (EMF) which will be created annually from the contributions of those interexchange carriers who use exchange facilities.

This EMF will remain fixed in time. So will the payments to each LOC. The size of the fund will be determined once and for all by examining total toll service payouts during the year immediately preceding enactment of the Bill. Disbursements to the LOC's will be in accordance with the amount of toll service revenue received (in the year preceding enactment) which was attributable to subsidies from SPF.

Assuming that what I have said is an accurate representation of what the BEMP is all about and how it works, I would like to comment on: (1) some of the philosophical foundations of the BEMP (as induced from the rationale of Section 222) and (2) what some of the effects might be.

Implicit in the manner in which the BEMP is set up and administered, is the assumption that the subsidies flowing from the toll pool, which are generated by the existing separations procedures, are economically inefficient and place an unfair burden upon the toll service user. Hence exchange access charges will be based on actual costs. The implementation of such a philosophy would result in an immediate decline in toll revenue to an LOC by the amount of the subsidy generated by the SPF—but the payout from the fixed EMF will, in the first year, make up for the shortfall in revenue. As the real value of the fund declines with time (due to inflationary effects) LOC's will have an economic impetus to stabilize profits by (1) reducing costs through operating efficiencies and new technology, and (2) stimulating interexchange service activity. Philosophically, I think that this concept makes good economic sense—and could, on a nationwide basis, result in better communications service at lower costs. We must, on the other hand, be prepared to deal with departures from the theoretical model.

Let us look at a possible scenario resulting from the application of BEMP. In the first year, the combination of access fee revenues and EMF payouts should not cause any serious losses in total operating revenues to an LOC. There should therefore be no discernible upward rate pressures upon local exchange service. However, if access fee revenues do not increase at a rate greater than the decline in the EMF, upward rate pressures will appear. And, if this were to occur, gentlemen, it is by no means certain that the cost-cutting fixes, or the introduction of new technology, will prevent an increase in local exchange rates. No one can predict now, with accuracy, the extent to which operating cost cutting measures or new technology will be effective within the industry. The Subcommittee should be aware, therefore, of the possibility that, in isolated cases, unrectifiable upward rate pressures may appear. The Subcommittee may wish to address this in its legislation. I would suggest that some language be added to the bill which would state the Congressional policy stance with respect to the possibility of upward rate pressures upon local exchange services and the possibility of any remedial action.

I would like now to address the practicability of the procedures which will be necessary to implement the EMF, and also to indicate some areas where we feel that more explicit guidance from the new legislation might be desirable. First, I will address issues associated with the setting of access charges, and then those issues associated with the administration of the EMF. Because I wish to be brief I shall depart from a narrative style and address the following issues one-by-one.

WHAT IS "UNLAWFUL DISCRIMINATION"?

Section 222(b) gives the Commission jurisdiction over the rates charged for access to local exchange facilities by the interexchange carriers and states that the Commission will have the authority to prevent unlawful discrimination. The nature of "unlawful discrimination" is not defined. Does it refer only to a departure from a

cost-based pricing scheme? Or does it, in addition, refer to a variation in non-monetary terms and conditions of service?

WHAT TYPE OF COST METHODOLOGY?

It seems clear that some type of exchange/interexchange cost separations procedure will be necessary to determine the costs of interexchange use of exchange facilities. Will these be relative us principles, similar to those embodied in the 1971 NARUC/FCC Separation Manual, or will they be cost-causal principles? If these principles are not to be defined in the Amendments, what will be the discretionary power of the Commission to determine them?

WILL AVERAGE SCHEDULE COMPANIES DO COST STUDIES?

The abolition of the current jurisdictional separations procedures will also abolish the former distinction between cost companies and average schedule companies. On the other hand, if the Commission is to have jurisdiction over the setting of access fees, it appears that each of the approximately 1,500 Bell and Independent companies would be required to perform some sort of cost study. For that 80 percent industry segment which was formerly on average schedules, this could be a considerable hardship. A possible solution would be to maintain the cost versus average schedule distinction in the provision of exchange facility access services too—thereby providing relief for the former average schedule companies.

CALCULATION OF THE EMF

The size of the EMF will be that amount representing the subsidy in excess of actual cost, due to the use of the SPF factor, paid out in the year prior to the enactment of the legislation. In order to determine this amount, it will be necessary to examine the records of the approximately 500 companies which use cost separations studies as a basis for obtaining toll settlement revenues. Using this information it will then be necessary to compute the toll service revenues which would have been obtained had SLU been used instead in the allocation of exchange plant. Now surfaces a dilemma which must be dealt with. I do not think that it would be logistically feasible for a Joint Board to perform this task on its own. On the other hand, if the carriers were to do it, they might rightly claim that they should be allowed to flow through to their customers the cost of performing the additional studies. Finally, if the carriers do perform these studies the Joint Board might be faced with an equally formidable monitoring task.

DISBURSEMENT OF EMF FUNDS TO FORMER COST COMPANIES

In 222(c), where the procedure pertaining to the disbursement of EMF funds to the former cost companies is specified, clarification is needed of the language referring to the costs of providing service "solely on the basis of relative use of exchange facilities by exchange and interexchange services". I have made the assumption that it means that SLU should be substituted for SPF.

DISBURSEMENT OF EMF FUNDS TO FORMER AVERAGE SCHEDULE COMPANIES

In 222(c)(2), where disbursement of EMF funds to former average schedule companies is described, the term "similarly situated", as it applies to cost companies, needs more precise definition. If "similarly situated" refers to companies with similar gross operating revenues or subscriber populations, it might be difficult to find a match since the majority of average companies are considerably smaller than cost companies. This is, indeed, one of the reasons that these smaller companies choose to be on average schedules.

ROLE OF JOINT BOARD

The responsibilities assigned to the Joint Board must be carefully balanced with the cost of carrying out these responsibilities. Two very big tasks must be performed on a one-time basis: Determining the size of the EMF and determining the size of the payout to approximately 1,500 companies. On a continuing basis, the Joint Board will be required to (1) monitor the economic activities of the interexchange carriers in order to determine the apportionment of contributions to the EMF and (2) periodically disburse the payouts to 1,500 companies.

It might be useful, therefore, if the Subcommittee staff were to investigate the feasibility of the Joint Board delegating some of its study effort and clerical work to industry in a manner similar to that in which the telephone companies themselves currently administer the toll settlements process.

I would like to conclude by saying that the basic concept of BEMP is sound, and that it meshes intelligently with the overall concept of the proposed legislation. However, because of the unpredictability of certain economic effects and of potential

implementation problems, the Commission and the Joint Board should be given statutory discretion to alter some of the rather specific formulations set forth, in order that we achieve the intent of Congress in an economically efficient manner.

Senator HOLLINGS. Very good. Thank you, Mr. Dujack.

Next is Mr. Stewart.

Mr. STEWART. My name is H. Milton Stewart, Jr., and I am chairman and chief executive officer of the Standard Telephone Co., Cornelia, Ga. I would like to express my appreciation to the chairman and members of this subcommittee for this opportunity to appear before you on behalf of my company.

I also serve on the board of directors of the Organization for the Protection and Advancement of Small Telephone Companies, OPASTCO, and on several committees of the U. S. Independent Telephone Association, USITA, and am chairman of the REA Borrowers Committee of USITA.

My testimony will focus on the access charge and basic exchange maintenance program, BEMP, proposals in S. 611 and S. 622. It may be useful to give you my own interpretation of the purposes, as I perceive them, of the proposed legislation.

My company serves approximately 34,000 telephones over a 1,570 square mile area of northeast Georgia and is one of 1,530 independent, or non-Bell, telephone companies that provide service to more than one-half of the geographical area and about one in every five telephones in the United States; 942 of these companies, including Standard, receive most of their capital financing through the REA telephone lending program. There presently are 251 cooperatives and 691 commercial REA telephone borrowers.

S. 622 seems to have as its goal the reduction of regulation, providing market place competition in place of regulation while insuring minimum universal voice grade telephone service at reasonable rates. Similarly, S. 611 seeks to deregulate and to encourage competition while insuring efficient nationwide telecommunications services, including public services, at reasonable cost.

We see a clear case for a regulated, cost-based monopoly; but we also observe the emergence of a competitive, nonregulated system that responds to market-based pricing disciplines.

Somewhere in between are the telephone companies, tossing about in a turbulent fluid that Congress hopes to stabilize through legislation. Having failed in my own efforts to mix oil and water, while watching my colleagues in the industry fail in similar efforts, and observing the inability of the regulators to perform this magic feat, it will be interesting now to observe Congress attempt at developing an oil and water "solution."

Turning to the tired old analogy of the railroads, passenger rail service has always been a virtual monopoly. As a means of transporting passengers from one point to another, it once flourished as a profitable service of the railroads.

Although passenger rail service is no longer profitable, it still remains a monopoly. The profitable portions of the passenger rail service have migrated to other forms of transportation, but passenger rail service continues to exist as a public necessity through heavy Government subsidization.

Certain elements of the American population appear to require subsidized transportation, and passenger service by rail has by

default become the combination of facility and service by which this particular social objective is accomplished.

It now appears to be an almost foregone conclusion that a parallel of the transportation problem exists with the provision of telecommunication service—that local telephone companies properly provide the feasible facility and service combination by which the social objective of “universal service at affordable rates” may be maintained.

The question becomes one of determining the proper mechanism to meet this objective without constraining the more effective marketplace system as a means of providing improved advancement of telecommunication service offerings.

This matter of subsidization of basic telephone service has been the crucial issue around which almost all other issues within the proposed legislation have revolved. That is: How may a mechanism be developed which will dispose of the universal service/reasonable rate objective so the gates may be opened to competition in telecommunications?

Unlike the House, the Senate approach—in both S. 611 and S. 622—has been to modify the existing Communications Act to deal only with those items that have become a problem due to changes in communication methods, technology and regulation. I believe this approach can and should be used in addressing the question of access to and contribution toward the provision of local service.

I submit that the present separations and settlements arrangement is a logical system for allocating costs and revenue requirements in a regulated, cost-based monopoly system. And, since we are addressing the matter of a basic exchange maintenance program for the purpose of supporting “the continued availability of basic exchange services at affordable rates,” it makes sense that this system be continued as a means of supporting monopoly local service.

Of course this does nothing to prevent the migration of profitable telecommunication business away from the monopoly sector and toward the competitive sector, which is free of regulation and able to respond to market-based pricing—what the market will bear—as opposed to cost-based pricing.

There are methods of mitigating the problem. Where competitive service offerings are not carrying a fair share of the contribution to local service as compared to MTS/WATS—and I suspect that this has been satisfactorily demonstrated in the ENFIA negotiations—the level of toll contribution to exchange operations must be adjusted by burdening these competitive offerings.

If that solution is not adequate to assure the continuation of “essential” service—that is, universal availability of state-of-the-art telecommunications service at affordable rates—then additional mechanisms to achieve equity such as deloading of terminal apparatus over a reasonable timeframe such as 8 to 10 years may be necessary.

It makes sense that interexchange carriers, including Bell, who attach to local facilities for the purpose of providing intercity services, should pay an access fee that is compensatory for the use of the facilities.

This includes an element of contribution to support local exchange telephone service. This contribution should apply to private line services just as it now does for message toll service, for which private line services are generally substitutable.

S. 611 comes reasonably close to addressing the considerations I have just cited. I would prefer not to exchange the present method of separations and settlement for the process proposed by S. 611, nor would I like to see the contribution element capped, as the bill proposes.

I doubt that a sufficient case has been made to support decreasing the contribution element. If such a case is made, I suggest that gradual terminal deloading would be more desirable and would be consistent with competition in the terminal market.

I would be opposed to the handling of funds through a joint board, but feel the industry should continue to handle division of its revenue under direct FCC oversight of the process.

I have mixed feelings about the system of surcharges imposed by S. 611 on all interexchange carriers to aid in the maintenance of local exchange service. As the carrier of last resort, the local telephone company is justified in receiving this additional compensation to aid in the attainment of the social objective of universal service at reasonable rates.

Similarly, for the good of the community and the Nation, individual taxpayers support the public schools whether or not they use the public school system.

However, a discriminatory contribution charge which applies only to certain carriers—that is, those who voluntarily choose to connect to the local exchange—will create a strong, and an economically inefficient incentive to find ways not to connect to the local exchange, regardless of whether the local exchange is the most efficient and cheapest alternative. This is not the way to stimulate a truly competitive intercity market.

We do not require factories that use their private lakes and dams to generate their own electricity to pay a contribution to the power companies to support affordable electric rates for homeowners, plus street lighting and traffic lights. Nor do we require beer companies that drill their own water wells to support the municipal water system that installs the fire hydrants and fills the community swimming pool. Those enterprises are not competing for water and electricity outside the local market area.

Much more time should be given to this most important and pivotal point of who should contribute to local exchange support, around which the issue of universal service versus competition revolves.

Certainly in the short time in which I have been able to develop a response to S. 611 and S. 622, it has been impossible to give the proposals of the bills the attention they deserve.

If universal service is an important public policy, one alternative would be to have the costs borne by all taxpayers. But this is not the year or political environment to adopt new general taxes or create a new \$4 billion Federal Government grant program.

Another alternative is to have all who benefit from telecommunications share in the cost of this policy. A surcharge to insure this

happens must apply indiscriminately to all carriers serving those users.

This is not a general revenue tax proposal. I believe those who benefit from the existence of state-of-the-art communications—including universal access anywhere in the Nation—should pay the full costs of those benefits, whether or not they use every carrier, every switch, every telephone cable, or every high-speed data link available to them.

Putting the matter into perspective, I believe that a major issue is average toll rates. The question has to be addressed and, for the record, I believe that average rates—that is, preventing rate disparities for services to rural areas compared to urban areas—must be insured through provisions of law.

In summary, and I will give this matter further consideration, I would suggest that some alteration, but not replacement, of our present separations and settlement arrangements would be in order and that the FCC should monitor the process.

Let me add, however, that placement of all interexchange service under the jurisdiction of the FCC, for the purpose of coordinating a fair and equitable intrastate/interstate rate structure, appears to be needed, as long as this does not require small companies to constantly be in Washington, D.C. States should continue to play a meaningful role in the process as agents of delegated Federal jurisdiction to minimize regulatory costs to small companies.

All private lines must carry an access charge that not only is compensatory for facilities used, but includes an element of contribution to the basic exchange network.

If the contribution element must be reduced, gradual deloading of terminal apparatus should be the first, and perhaps only, approach considered. I am reluctant to endorse the basic exchange maintenance program as described in S. 611, since I believe the above recommendations would have a far less disruptive effect, while providing a framework within which further refinements could evolve.

Finally, merely as a matter of information to the subcommittee, our company has examined our toll revenue requirements for 1973-77, and then applied the BEMP proposal, as we understand it, for the same period. In 1977 revenue under the basic exchange maintenance program would have fallen 14 percent short of our actual separation and settlements revenues for that year.

Again, thank you for the opportunity to appear before this subcommittee and for hearing my remarks.

Senator HOLLINGS. Thank you, Mr. Stewart.

Mr. Case?

Mr. CASE. Mr. Chairman and members of the committee:

I am Weldon W. Case, and I am here today representing the U.S. Independent Telephone Association as the chairman of its Settlements and Separations Committee.

I am also the president of Mid-Continent Telephone Corp., a telephone holding company, headquartered in Hudson, Ohio, which through 22 operating subsidiaries serves about 900,000 telephones in 12 of our States.

The following figures concerning the independent telephone industry's toll revenue are of particular significance in light of what

a fixed basis and let the others slide. It's going to be like the three-legged milking stool with one short leg, that eventually will tip and allow the thing to fall over.

USITA recognizes that the present separations and settlements procedures were developed in a monopoly environment and probably do deserve some modification.

It's USITA's position that all intercity carriers certainly should pay a universal service contribution and surcharge established by a Federal/State joint board to cover whatever revenue shortfalls are involved.

I think, in concluding, I should have to say that we of USITA are opposed to the elimination of the settlements and separations procedures, as we now know them. We are opposed to—certainly, we caution against—allowing the joint board to administer any funds that might come along.

I thank you very much for the opportunity to appear today.
[The statement follows:]

STATEMENT OF WELDON W. CASE ON BEHALF OF THE UNITED STATES INDEPENDENT
TELEPHONE ASSOCIATION

Mr. Chairman and members of the Subcommittee, I am Weldon W. Case and I appear before you today representing the United States Independent Telephone Association. I am a member of the USITA Board of Directors, an officer—its Treasurer, and Chairman of the USITA Settlements and Separations Committee.

I am also President of the Mid-Continent Telephone Corporation, a telephone holding company, headquartered in Hudson, Ohio which, through 24 subsidiary operating telephone companies, serves about 900,000 telephones in 12 states.

USITA is the national trade association which represents over 1,500 Independent (non-Bell) telephone companies providing local and long distance telephone service in over half of the served geographical area of the lower 48 states and in all of Hawaii and Alaska. USITA's telephone company members range from small "mom and pop" owned and operated companies to our largest member, GTE, which serves approximately 14.3 million telephones in this country. That many of our members serve the rural areas of America is illustrated by the fact that 670 companies are REA borrowers and 113 companies are cooperatives. Our member operating telephone companies represent 95 percent of the Independent telephone industry in terms of stations, 97 percent in terms of gross revenues and 96 percent in terms of plant investment. The Independent telephone industry's share of the telephone industry in this country, whether measured in terms of stations, revenues, investment, employees, et cetera ranges generally between one-fifth and one-sixth of the total.

As meaningful as the statistics I have just mentioned are, the following figures concerning the Independent telephone industry's toll revenues are of particular significance in light of what I perceive as major adverse impacts that S. 611 and S. 622 as proposed would have on Independents in the area of separations and settlements. In 1978 the Independent telephone industry's toll revenues amounted to over 4¼ billion dollars. This amount represents the Independent industry's share of state and interstate toll revenues resulting from the joint Independent-Bell provision of toll services. This amount also represents over 50 percent of the Independent industry's total revenues.

The remainder of this statement will deal with (1) an overall assessment of the proposed Senate bills in the settlements and separations area, (2) comments on some of the specifics concerning the proposed access charges and the Basic Exchange Maintenance Program (BEMP) and (3) USITA's views on what the thrust of the legislation should be in the area of separations and settlements.

In assessing the overall impact of the proposed legislation relative to separations and settlements there are two major concerns. First, there is the indication in S. 611 that the proposed access charge and contribution mechanism is intended to be an appropriate and complete substitute for the existing separations and settlements process. This proposal would leave the industry and its regulators without a process for identifying for ratemaking and settlements purposes a significant amount of costs incurred by operating telephone companies in the provision of toll services. Secondly, we believe the proposed contribution mechanisms will cause basic ex-

USITA has a great concern about the basic exchange maintenance program in S. 611. This concern relates primarily to the fixity of the fund. Any fixing of the level that is used to support basic exchange service rates means that over time the support will decrease in a relative sense, and basic exchange rates will have to be increased.

There seems to be a presumption in the bill that a phasing down of the contribution level in a relative sense will provide time for local telephone companies to find other sources of revenue to support local service rates. While this may be theoretically possible, from a practical point of view, the capping of the contribution level will no doubt force local telephone companies to increase basic exchange service rates. This appears entirely contrary to the stated purpose of the proposed act, of making available, so far as possible, to all the people in the United States, rapid, efficient, nationwide, and worldwide telecommunications services with adequate facilities at reasonable charges.

I have described and defined what I believe to be the functions of the separations and settlements process. The concern of the independent industry and of myself with S. 611 is that that does not address at least one-half of the total cost and the total revenues that currently are a part of the independent industry's revenue picture. I have identified those items as: Ticketing functions, operator office functions, and the like.

And so with only half of the revenues even considered, our local service revenues are going to have to be increased at a rate of about 25 percent in order to immediately offset this shortfall. I call attention to the fact that the annual revenues per main station telephone in our own company last year were \$343.42. You can easily compute what 25 percent of that amount might be in a local service rate increase to immediately make up for that shortfall. To my learned colleague on my left representing the commission in Minnesota that may pose some problems.

The other part that has perhaps not been addressed properly is the freezing of the so-called BEMP contribution. As an example, in the last 3½ years the total contribution from toll cost per main station has risen from \$3.85 per month to \$6.20. In the mere period of 5 years from the freeze date, we would find there would be something in the neighborhood of a 40-percent contribution shortfall.

And I call your attention to the fact that once again we would require rate cases filed with the local commissions in order to raise local service rates to make up for that shortfall.

The idea of establishing a dollar amount in this rather volatile economy is rather strange to me. If we established the price of butter at \$1.02 a pound—and I have no idea whether that's the right price—and we say, "From now on that is going to be the price of it," we absolutely lose sight of the fact that the cows may not produce more milk to get more butter, or we may have a technological breakthrough, or that people may not eat as much butter and the price may go down. On the other hand, inflationary forces may force it to rise.

So, I just am not able to, in any way, shape, or manner, justify in my own mind how we can price one piece of our revenue picture on

a fixed basis and let the others slide. It's going to be like the three-legged milking stool with one short leg, that eventually will tip and allow the thing to fall over.

USITA recognizes that the present separations and settlements procedures were developed in a monopoly environment and probably do deserve some modification.

It's USITA's position that all intercity carriers certainly should pay a universal service contribution and surcharge established by a Federal/State joint board to cover whatever revenue shortfalls are involved.

I think, in concluding, I should have to say that we of USITA are opposed to the elimination of the settlements and separations procedures, as we now know them. We are opposed to—certainly, we caution against—allowing the joint board to administer any funds that might come along.

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In assessing the overall impact of the proposed legislation relative to separations and settlements there are two major concerns. First, there is the indication in S. 611 that the proposed access charge and contribution mechanism is intended to be an appropriate and complete substitute for the existing separations and settlements process. This proposal would leave the industry and its regulators without a process for identifying for ratemaking and settlements purposes a significant amount of costs incurred by operating telephone companies in the provision of toll services. Secondly, we believe the proposed contribution mechanisms will cause basic ex-

change telephone rates to have to be increased to the point where the universal service goal may be threatened.

Section 222(a) of S. 611 calls for the termination of existing jurisdictional separations 180 days after the date of the enactment of the bill and for the replacement of jurisdictional separations with an access charge and a Basic Exchange Maintenance Program (BEMP). This language appears to indicate a failure to recognize that all operating telephone companies, Independent and Bell, incur costs associated with the joint provision of interexchange services which are over and above those related to access lines and the contribution element. These other costs, to name a few, include manual and automatic toll switching costs, manual and automatic toll message recording costs, interexchange trunk plant costs and Commercial and Revenue Accounting costs associated with toll service billing. The structure of the network is not one of islands of local distribution facilities provided by operating telephone companies interconnected by interexchange facilities owned and operated solely by A.T. & T.'s Long Line Department. To illustrate this point, for the Independent telephone industry, on the average, only about one-half of toll settlement revenues relate to costs associated with non-traffic sensitive local distribution facilities and the contribution element. To put it simply, the basic function of separations for settlements purposes is to equitably divide revenues from interexchange services among the joint-providers of such services. Regardless of how access charges and contribution is handled, the need for separations to divide these revenues does not change—the process has to exist.

There is another reason why the separations process will be required in the foreseeable future. The basic need for separations, of course, is the fact that most telephone plant is jointly used in providing more than one service e.g. local exchange service, state toll service and interstate toll service. With the requirement of the legislation to allocate all costs including joint and common costs between non-competitive services and competitive services or products, separations will continue to be a needed key mechanism for the telephone industry and its regulators.

While it is understood that the intent of S. 622 is that jurisdictional separations would continue in much the same manner as it does today, except for changes necessary because of the proposed movement of the Federal/State jurisdictional boundary, this intent is not clear from the language of the bill and should be clarified.

The following are comments regarding the proposed access charges and contribution mechanisms.

USITA is in accord with the intent of both Senate bills that carriers that interconnect with local distribution facilities of the local telephone company should make equitable payments for the use of such facilities. Our interpretation of the language of both S. 611 and S. 622 is that such access charges would include non-traffic sensitive costs at the SLU level plus traffic sensitive costs for local switching and local trunking. While the language of S. 611 indicates that there would be continuing access changes at levels set by the FCC, the language in S. 622 indicates that access charges would end in six years or sooner if it was determined such charges were not needed to maintain reasonable voice grade-telephone service and promote improved service through use of new technology. If such termination of access charges is not intended, the language in S. 622 should be clarified.

USITA has great concern about the Basic Exchange Maintenance Program in S. 611. This concern relates primarily to the capping of the BEMP fund. Any fixing of the level of the contribution that is used to support basic exchange service rates means that over time this support will decrease in a relative sense and basic exchange rates will have to be increased. There seems to be a presumption in the bill that a phasing down of the contribution level in a relative sense will provide time for local telephone companies to find other revenue sources to support local service rates. While this may be theoretically possible, from a practical point of view the capping of the contribution level will no doubt force local telephone companies to increase basic exchange service rates. This appears entirely contrary to the stated purpose of the proposed act "of making available, so far as possible, to all the people of the United States, rapid, efficient, nationwide and worldwide telecommunications services with adequate facilities and reasonable charges."

USITA understands that the amount of the BEMP fund, expressed in settlements terms, would reflect, for the year preceeding the passage of the proposed act, the SPF settlement level minus the SLU settlement level times 110 percent. It is assumed in this calculation that intrastate toll settlement amounts would be included as well as interstate toll settlement amounts. Based upon 1978 data, USITA estimates that the Independent industry portion of the BEMP fund would amount to approximately 1.4 billion dollars.

Another aspect of the Basic Exchange Maintenance Program which is of concern to USITA is the proposal that a special permanent Joint Board should have complete responsibility for administering the Program including the collection and disbursement of the fund. It appears that the authority proposed to be given to the Joint Board in this regard may be in response to criticism by entities outside the telephone industry that the contribution element of the separations and settlements process should not be administered by the telephone industry because of the apparent fear that the industry would somehow misuse or otherwise abuse the process. USITA disagrees with this position entirely. The contribution element of the existing Ozark separations procedure and of separation procedures that preceded Ozark have been developed by joint participation of Federal and State regulators and the telephone industry and has been in the past and is today subject to constant oversight by both Federal and State regulators through ratemaking proceedings. It is USITA's position that access charges and any contribution that is necessary to support basic telephone rates should be determined by a Federal/State Joint Board but administered by the industry with Joint Board oversight.

Addressing now the contribution component of the access charge proposed in S. 622, USITA believes there is no question it is needed and no question the need will continue beyond six years. Let me illustrate this point. Several years ago, a USITA separations research task force determined that the use of existing SPF separations procedures, as compared to the use of SLU procedures, contributed on the average about \$3.85 per month per main station from toll services to help maintain reasonable basic exchange service rates. This amount, applicable to the Independent telephone industry, was based upon a 1974/1975 level of business. The same calculation, based upon a 1978 level of business, shows that the contribution amounted on the average to about \$6.20 per month per main station. This support explains to a large degree why telephone companies have been able to keep requests for increases in basic exchange service rates modest. Without this support, this revenue will have to come from local ratepayers through higher basic exchange service rates.

USITA recognizes that the present separations and settlements procedures, which were developed in a monopoly environment, need certain modifications to function properly in a competitive environment. However, these modifications need not be and should not be as drastic as those envisioned by the Senate bills. What we see as needed is a modification of the present separations process whereby access line costs and regulated basic local service and basic intercity service costs can be separately identified. Access line charges applicable equitably to all intercity carriers connecting to the local telephone company distribution facilities should be determined by a Federal/State Joint Board. If revenues from access charges and reasonable, affordable basic local and basic intercity services are not sufficient to cover revenue requirements of these services, it is USITA's position that all intercity carriers should pay a universal service (contribution) surcharge established by a Federal/State Joint Board to cover the revenue shortfall. Intercompany settlement arrangements, including revenues associated with access charges and any universal service surcharge should be administered by the industry with regulatory oversight through a Federal/State Joint Board.

Thank you for the opportunity to express USITA's views on this very important matter. I'm sure we share the belief that separations and settlements is one of the key policy areas to be addressed in any new communications legislation.

Senator HOLLINGS. Thank you, Mr. Case.

Ms. Sasseville.

Ms. SASSEVILLE. Mr. Chairman, thank you for inviting me to this very important meeting. You are dealing with issues that strike close to the heart of some of our most profoundly held values. The issue of competition is the issue of individual rights and liberties: The right to own property and freely choose how to use it. And the issue of universal service is the issue of the right of every American to have equal access to an essential service that can mean the difference between life and death.

When we deal with such issues, it is often difficult to separate the issues from the nonissues, and I would like to separate out the chaff from the wheat. Although everyone now agrees competition is here to stay, State legislators remain concerned that proposed legislation, the deregulation of interstate traffic on lower density routes could take place before full and fair competition was a

realistic prospect. We need to guard against de jure competition in the absence of de facto competition.

In rural areas, especially, basic exchange service could be damaged by such an eventuality. The key to resolving this problem appears to lie in the timeframe which Congress provides for transition from regulated monopoly to free and fair competition. The timeframe and the flexibility of conditions under which we protect the emergency of incipient competition are crucial. I believe that the timeframes in S. 611 need to be lengthened and additional flexibility established.

A nonissue which has sidetracked us in the debate is whether rural telephony shall survive. Of course, it is in the national interest to provide efficient, reliable telecommunications services for rural America, and at just and reasonable rates. And if that requires subsidy, we should expressly subsidize. And in this respect, S. 611 recognizes that this nonissue which has so distracted us must at last be set aside.

However, I am not convinced that the bill adequately deals with the real issue, which is, of course, how do we protect the ability of the companies in question to meet our communications goals, given the reality of competition. Let us pray that the fate of the rural branch rail line is not the fate of the nominally competitive toll line from Wadena to Bemidji.

While section 222 goes in the right direction, I think it fails to adequately recognize that there is a link between cost-based settlements and the need for subsidies in certain rural areas, and that only the State commissions have the proximity to understand and resolve.

In any change to the present separations and settlements system, I would propose that settlements, or cost-allocated local exchange payments, as I would prefer to call them, should be handled by and through the State regulatory commissions so that the special needs of rural, low-density, difficult terrain or other special exchanges can be considered. But again, I suggest that flexibility and an adequate timeframe will be necessary to work out these problems in the public interest.

Third, let me pose another nonissue and its concomitant real issue—and now I think we are getting to the heart of the matter. Whether competitive services should be priced at cost is a nonissue. How we price at cost is the issue.

The competitors in the market will price at cost. They will price at marginal costs. And if they wish to engage in anticompetitive activity they will price below marginal costs on certain items and make it up on others.

So I say the real issue is how we define costs. How we allocate costs and how we price services so as to maintain economic efficiencies and equity between basic and vertical services, between local and interexchange services, between competitive and monopoly markets and between customer classes. And here S. 611 has made a significant contribution to the protection of the local exchange integrity by mandating a new system of accounts.

One of the most frustrating aspects of being a State regulator is the feeling that under the present system we cannot discover with any kind of certainty where there are subsidies existing, because

the concepts of cost accounting, functional accounting, and exchange accounting are alien to the industry. Yet, without them, regulators cannot claim to truly understand the effects of our actions.

But however important it is that this task be undertaken, it is more important that it not be undertaken in a hurried manner with inadequate input from all the interested parties.

Revising the uniform system of accounts is a complex and enormous endeavor, and it is so central to all the other issues that I believe it should be completed prior to moving on to any other aspect of deregulation. No other issue contemplated in this legislative proposal can be undertaken with confidence in the absence of appropriate and acceptable accounting practices.

Related to cost accounting is another real issue and its shadow nonissue. We have debated fruitlessly the nonissue of whether local exchanges should be deprived of separations and settlements and forced to double rates for local service. I claim that is a nonissue because it contains two erroneous assumptions: First, that settlements actually recover the costs of providing interexchange access; and second, that they represent the only means to do so. Neither assumption is valid.

Now, this is a highly flammable issue in State regulatory circles, and I am going to incur the wrath of all my peers if I fail to carefully define what I think the real issue is here. I refuse to refer to settlements or to toll revenues as subsidies, because the fact is they are intended to recover from toll users their share of operating a system which allows us to initiate and complete their toll calling. The toll network would be useless if the local exchanges were not required to provide an interconnection, and toll use at the local exchange does, in fact, impose costs and burdens on the local system and its users. And it is fair and reasonable to expect these costs to be paid and those burdens compensated even though separations and settlements are not based on precise cost determinations.

But I have not answered the question I posed: What is the real issue here? It is simply that the present system of separations and settlements will not work in a world of expanding competition where new entrants will price at marginal costs.

Thus, we need to find a system that will accomplish several goals: It must appropriately define the costs of facilities and operations, jointly and commonly used to provide both intra- and inter-exchange services. It must find a way to recover these costs fairly from all users, whether or not they use the interexchange network to complete their calls. And it must find a means to distribute these revenues to the local exchanges in a manner that is not only cost-oriented but that is fair and equitable and which will not introduce incentives either to overinvest or to underinvest.

In other words, we must find a system that is consistent with the goals of the Communications Act and of this committee and of the State regulators of exchange service.

And let me say here that I think section 222 makes another fine contribution because it does identify this real issue. Again, however, I feel that the issue is far more complex than the legislation appears to assume. We cannot quickly and easily slide from one

system to another just because we want to. A lot more study is needed to determine the best means to identify and define costs and to find a procedure that balances the many conflicting interests and goals in a manner that is both efficient and just. Flexibility is the key.

My personal view of the proper allocation of costs between inter- and intraexchange services is that complicated formulae are unnecessary. They confuse and create economic dislocations when they change.

Let me suggest a system that would, I think, be simple and equitable. We should recognize that, except for interconnection, both the local exchange system and the interexchange system would have to separately incur the total costs of replicating the local exchange. And so would each and every competitive provider of interexchange service. It is precisely to avoid these exorbitant costs of duplication that local monopolies were established and protected by State and Federal law in the first instance. On opportunity-cost principles, therefore, it seems economically correct and fair that intra- and interexchange users should share equally the costs of providing joint and commonly used facilities and operations. A 50-50 cost allocation would provide a simple, equitable, and permanent solution to this particular problem.

Finally, let me discuss the question of the role of the States. The State regulators with whom I have spoken are concerned that Congress will not allow a sufficiently long-timeframe or sufficient procedural flexibility to accomplish our mutual aims in an appropriate manner. We are concerned that a too-rigid and too-early attempt to shift from an obsolete monopolized market to a de jure competitive market in the absence of de facto free and fair competition may bring about adverse and unanticipated consequences.

However, I feel that the bill's provision for a permanent joint board offers the answers to the problem I have suggested. A permanent joint board if—but only if—it were adequately funded and staffed could take step one. It could set about immediately to assist the FCC in a task they have begun, to revise the uniform system of accounts. Once accomplished, we would have the means to discriminate between improper interclass, interservice, and intermarket subsidies, and then we could begin to take some of the other steps this bill proposes.

I strongly encourage the immediate creation of a permanent joint board with its own independent staff. If such a board is created and begins work immediately, we will be well on our way to resolve the problems we have discussed for years.

Thank you.

[The statement follows:]

STATEMENT OF CHAIRMAN KATI E. SASSEVILLE, DEPARTMENT OF PUBLIC SERVICE,
STATE OF MINNESOTA

Mr. Chairman, members of the committee, ladies and gentlemen, thank you for inviting me to this very important hearing, and for the opportunity to put on the record my views about the great telecommunications issues with which you are contending.

You are dealing with issues that strike close to the heart of some of our most profoundly held values. The issue of competition is the issue of individual rights and liberties—the right to own property and freely choose how to use it. And the issue of universal service is the issue of the right of every American to have equal access

to an essential service that can mean the difference between life and death. In modern life the ability of the state—the township or the city—to protect the health and safety of its citizens—is contingent upon their access to reliable telephone service. These are gut issues and it is no wonder that the prospect of change in the telecommunications industry is such a threatening prospect to so many. But the tensions that competition has introduced are real. The world is changing, and you are courageously recognizing your responsibility to face and resolve these issues in the interests of all Americans.

But when we deal with such fundamental issues it is often difficult to separate out the non-issues from the real issues, and I think that the debate in recent years has too often bogged down on extraneous questions and obscured the real issues.

So I'd like to try to separate out the chaff from the wheat.

First of all, the question is not whether we want competition. Competition is here to stay. There is a competitive imperative that says. If you can figure out a way to make a buck by doing a job for me and saving me money at the same time, we're going to get together, and artificial constraints may slow us down, but they aren't going to stop us. And that's what the new technologies have meant. And thank heaven, all the actors finally seem to have recognized that competition cannot be kept out of communications by governmental fiat. And should not be. However, the effort to protect monopoly from the incursions of competition has left a debris in which the real issue is, almost buried. And that issue is which are the markets where competition will flourish in the absence of governmental constraints, and which are the markets where the potential for competition will not be realized simply by deregulation?

And that is a very important question, because if a law is framed which fails to distinguish between those kinds of situations, the provisions which allow fair competition in the one, will only serve to spur monopoly toward unfair and exploitive tactics in the other. And allow is to engage in anti-competitive activity which will ensure its dominance of its markets in perpetuity.

State regulators remain concerned that under the proposed legislation the deregulation of inter-city traffic on lower density routes could take place before full and fair competition was a realistic prospect. We need to guard against *de jure* competition in the absence of *de facto* competition.

The key to resolving this problem appears to lie in the time frame which Congress provides for transition from regulated monopoly to free and fair competition. The time frame and the conditions under which we protect the emergence of incipient competition are crucial. The time frames in 611 need to be lengthened and additional flexibility established.

Another nonissue which has sidetracked us whether rural telephony shall survive. Of course, it is in the national interest to provide efficient, reliable telecommunications services for rural America, and at just and reasonable rates. And if that requires subsidy, we should expressly subsidize. And in this respect S. 611 recognizes that this non-issue which has distracted us must be set aside. However, I am not convinced that S. 611 adequately deals with the real issue which is, of course, how do we protect the ability of the companies in question to meet these goals, given the reality of competition?

While Section 222 goes in the right direction, I think it fails to recognize that there is a link between cost-based settlements and the need for subsidies in certain rural areas, and that only the State Commissions have the proximity to understand and resolve the problem of that link. In any change to the present separations and settlements system I would propose that settlements—or "cost-allocated local exchange payments" as I would prefer to call them, should be handled by and through the state regulatory commissions, so that the special needs of rural, low density, difficult terrain or other special exchanges can be considered. But again, I suggest that flexibility and an adequate time frame will be necessary to work out these problems in the public interest.

Third, let me pose another non-issue and it concomitant real issue. (And now, I think we are getting to the heart of the matter.) Whether competitive services should be priced at cost is a non-issue. How we price at cost is the issue. The competitors in the market will price at cost. They will price at marginal costs. And if they wish to engage in anti-competitive activity they will price below marginal costs, on certain items and make it up on others. So, I say the real issue is how we define costs, how we allocate costs and how we price services so as to maintain economic efficiencies and equity between basic and vertical services, between local and inter-exchange services and between competitive and monopoly markets. And between customer classes. And here S. 611 has made a significant contribution by mandating a new system of accounts.

One of the most frustrating aspects of being a state regulator is the feeling that under the present system we cannot discover with any kind of certainty where there are subsidies existing. Because the concepts of cost-accounting, functional accounting and exchange accounting are alien to the industry. Yet without them, regulators cannot truly claim to understand the effects of their actions.

But however important it is that this task be undertaken. It is more important that it not be undertaken in a hurried manner with inadequate input from all the interested parties. Revising the uniform system of accounts is a complex, an enormous endeavor. And it is so central to all other issues that I believe it should be completed prior to moving on to any other aspect of deregulation. No other issue contemplated in this legislative proposal can be undertaken with confidence in the absence of appropriate and acceptable accounting practices.

Related to the issue of cost accounting is another real issue and its shadow non-issue. We have debated fruitlessly the non-issue of whether local exchanges should be deprived of separation and settlements and forced to double rates for local services. I claim that is a non-issue because it contains two erroneous assumptions: First, that settlements recover the costs of providing inter-exchange access, and second, that they represent the only means to do so. Neither assumption is valid.

Now this is a highly flammable issue in State regulatory circles, and I am going to incur the wrath of all my peers if I fail to carefully define what I think the real issue is here. I refuse to refer to settlements, or to toll revenues, as subsidies. Because, the fact is that they are intended to recover from toll users their "Fair Share" of operating the system which allows them to initiate and complete their toll calling, the toll network would be useless if the local exchanges were not required to provide an interconnection, and toll use of the local exchange does in fact impose costs and burdens on the local system and its users, and it is fair and reasonable to expect those costs to be paid and those burdens compensated, even though separation and settlements are not based on precise cost determinations.

But I have not fully answered the question I posed: What is the real issue here? It is simply that the present system of separation and settlements will not work in a world of expanding competition where new entrants will price at marginal costs. Thus, we need to find a system that will accomplish several goals: It must appropriately define the costs of facilities and operations jointly and commonly used to provide both intra and inter exchange services. It must find a way to recover these costs, fairly, from all users, whether or not they use the inter-exchange network to complete their calls; and it must find a means to distribute these revenues to the local exchanges in a manner that is not only cost-oriented, but that is fair and equitable, and which will not introduce incentives to over-invest or to under-invest. In other words, a system that is consistent with the goals both of the Communications Act, and of this committee, and of the State regulators of exchange service.

And let me say here that I think section 222 is another fine contribution because it identifies the real issue. Again, however, I feel that the issue is far more complex than the legislation appears to assume. We cannot quickly and easily slide from one system to another just because we want to. A lot more study is needed to determine the best means to identify and define costs and to find a procedure that balances the many conflicting interests and goals in a manner that is both efficient and just. Flexibility is the key.

My personal view of the proper allocation of costs between inter and intra-exchange services is that complicated formulae are unnecessary. They confuse and create economic dislocations when they change. Let me suggest a system that would, I think be both simple and equitable. We should recognize that except for interconnection. Both the local exchange system and the inter exchange system would have to separately incur the total costs of replicating the local exchange. And so would each and every competitive provider of inter-exchange service. It is precisely to avoid these exorbitant costs of duplication that local monopolies are established and protected by State and Federal law in the first instance. On opportunity cost principles, therefore it seems economically correct, and fair, that intra and inter-exchange users should share equally the costs of providing joint and commonly used facilities and operations. A fifty-fifty cost allocation would provide a simple, equitable and permanent solution to this particular problem.

Finally, let me discuss the question of the role of the States. We are gratified that S.611 recognizes the essential role of the States in regulating local exchange service and in defining such service. State regulators are willing to work with Federal officials in further delineating and defining the many specific problems that will need to be addressed before these complicated issues can be finally resolved in the public interest. The goals of the Communications Act reaffirmed here are also the goals of the State Communications Act. It is our mutual goal now to devise proce-

dures which will continue to advance those goals while at the same time offering protection to a developing competitive communications market.

The state regulators with whom I've spoken are concerned that Congress will not allow a sufficiently long time frame or sufficient procedural flexibility to accomplish our mutual aims in a appropriate manner. We are concerned that a too rigid and too early attempt to shift from an obsolete monopolized market to a "De Jure" competitive market in the absence of de facto free and fair competition may bring about adverse and unanticipated consequences. We are afraid such a move might limit our ability to deal with these changing market structures in the public interest.

However, I feel that the bill's provision for a permanent joint board offers the answer to the problem I have suggested. A permanent joint board, if (but only if) it were adequately funded and staffed could take step one. It could set about immediately to assist the FCC in the task they have begun to revise the uniform system of accounts. Once accomplished we would have the means to discriminate between improper inter-class, inter-service and inter-market subsidies, and then we could begin to take some of the other steps this bill proposes.

Incidentally, let me point out here that I distinguish between proper and improper subsidies. A proper subsidy is one that is explicitly identified in a public decision. It recognizes the costs of providing a given service but it also recognizes that it may be appropriate for other services to share in those costs.

I strongly encourage the immediate creation of a permanent joint board with its own independent staff. If such a Board is created and begins work immediately we will be well on our way to resolving the problems we have discussed for years. Once we have fair functional cost accounting standards we can get on with the task of removing regulatory barriers where they inhibit innovation and efficiency. And we can then decide where we need to preserve regulatory constraints where they are necessary to protect the public interest in markets which are de facto monopoly markets.

I applaud this bill as an important step in the right direction and I offer you whatever assistance I can provide in the resolution of our problems of mutual interest. Other state regulators are equally willing to offer their assistance and I hope you will fully avail yourself of the opportunities they offer.

I think it has become clear to most of the industry and the regulators that once competition enters a formerly monopolized market. The basic issue becomes one of pricing. Fair cost allocation will allow equitable pricing practices in both competitive and monopoly markets. And where there is a need to provide subsidies to certain sectors of the market those decisions should be public ones and they should be made by the state commissions which are familiar with the circumstances requiring subsidies.

State regulators will be able to do their job in this regard if Congress allows them sufficient flexibility and sufficient time. But the call for time should not mean a delay in starting. I hope that this session Congress will enact enough provisions of this bill to get the permanent joint board in operation on the accounting questions, and I hope that the remaining provisions of the bill will serve as policy guidelines to the Board in a charge to develop for Congress a better defined and more detailed scenario for the move toward eventual free enterprise in communications. I would hope that such a joint board would provide regular reports to Congress on its progress in meeting these goals and to its success in working out effective techniques to implement the intent of this bill over a reasonable period of time.

Mr. Chairman, members of the committee, thank you for the opportunity to appear here today.

The CHAIRMAN. Thank you, Ms. Sasseville.

Jack.

Senator SCHMITT. Thank you, Mr. Chairman.

Thank you, panel, for your very interesting testimony.

Ms. Sasseville, I particularly thought your paragraph on page 5 was an important statement of philosophy. How we turn that philosophy into numbers is part of the reason for the hearings.

I would first like to ask a few clarifying questions.

Mr. Stewart, you used the expression "deloading of the terminal apparatus." Would you elaborate on what that means.

Mr. STEWART. A good portion of the investments that we have are in telephones and apparatus, principally the mechanisms that are on the house side or the business side of the protection unit.

That is where the lines comes to the house and then from that point on in is what I mean by terminal apparatus.

By deloading it, I am proposing that, if it's necessary—and I don't advocate that, but if it's necessary—to deload, that that portion be taken out of the process by which we determine separation and settlements. In other words, there would be no settlements afforded for terminal apparatus.

Senator SCHMITT. So you're really talking about impacting the separations and settlements process.

Mr. STEWART. Reducing the revenue requirements.

Senator SCHMITT. Taking terminal equipment out of that process.

Mr. STEWART. Yes, sir.

Senator SCHMITT. You also advocated that all users, whether they were using the local exchange facilities or not, should pay a surcharge.

Mr. STEWART. Yes.

Senator SCHMITT. And you use the analogy of the transportation industry. But buses and airplanes don't pay any access charge to support of the rail system.

Mr. STEWART. Senator, I left out a portion because I thought I was going to run out of time, that did address that.

I would be glad to review it if you have the time for it at this time.

Senator SCHMITT. Can you summarize why you think there are differences?

Mr. STEWART. Yes; in transportation you've got certain elements of the society who need transportation but who simply can't afford to pay the going rates, so they're subsidized. This is done through Amtrak.

That was picked as the service and the facility, or it became that by default—I am not sure exactly how Amtrak came into the picture—by which passenger rail service would be available to everybody. And apparently, in the telephone industry we have a very similar analogy since we, by default, have the servicing facilities by which everybody should have an opportunity to get telephone service or communications service at affordable rates.

Now, there are many alternative ways of transmitting information from point A to point B other than telephone service, just as there are many different ways such as airplanes and cars to transport people from A to B.

The point I was making in the analogy I was trying to draw was that still there is an element of society that has to be taken care of both in the matter of transportation and in the manner of communications.

Does that answer the question?

Senator SCHMITT. I believe the analogy tends to break down when dealing with what we would consider a universal basic service. We are not trying to provide universal basic rail transportation service to all citizens of the country; whereas as a statement of policy in these bills, we are saying that basic voice telephone service is a universal right.

Mr. STEWART. I understand what you are saying, and I went to great pains to avoid using the term "universal rail service" by calling it "passenger rail service."

Senator SCHMITT. In those cases the Government is providing subsidies for Amtrak directly, and to the buses indirectly through the highway system.

Mr. STEWART. You make my point.

Senator SCHMITT. Where we're dealing with a communications system, however, we are dealing with a system that interconnects all people. The only way all people more or less are interconnected in a transportation system is through the automobile. The closest analogy to the telephone system probably is the highway system.

But on the other hand, the highway system has traditionally been provided by governments; whereas private industry developed the phone system.

I have used the highway analogy myself many times, but through the education process I have tended to move away from it because of these kinds of differences.

For the panel: It was the intent of S. 622 to accommodate the existing separations and settlements procedures while establishing an access charge to be paid by interconnecting interexchange carriers. The access charge would include the elements of the actual cost plus a contribution to maintain reasonable rates for basic service, similar to what was negotiated in the ENFIA tariff proceedings.

Are these two concepts—that is, an access charge and the existing separations and settlements procedures—necessarily incompatible? Would any of you like to comment on that?

Mr. DUJACK. Yes, they are incompatible. The way it works now, basically—and there is only one interstate entity basically, the Long Lines Department of A.T. & T. Long Lines plus the originating carriers pool their revenues, and they extract money out of this revenue pool in accordance with the separations and settlements procedures. Comes competition, and you have five, six, seven, or eight interexchange carriers competing for the same ball between point A and point B. And they presumably will be going in with different rates, because we will have competition in terms of rates and other different bells and whistles. It doesn't make sense to pool revenues anymore. When you pool revenues, that means all you get out is your costs. Under completely free competition you're getting revenues regardless of the costs you are incurring, which are nobody else's business, theoretically.

And so interexchange competition and the use of the existing separational procedures, separations and settlements procedures, in conjunction with the pooling arrangements we have now are basically incompatible. However, we will still have to maintain existing separations procedures. The methodology will be required in order to compute access costs. So, to that extent—

Senator SCHMITT. Do you also have to provide a mechanism to oversee the local exchange contribution?

Mr. DUJACK. Yes, sir. And by the way—

Senator SCHMITT. You basically said they're not incompatible, but they're different. The situation is different, but with the access charge—

Mr. DUJACK. Then competition is compatible.

Senator SCHMITT. The access charge becomes an overhead charge that basically everybody utilizing the same facilities will pay.

Mr. DUJACK. It would work very similarly to international record communications now. If you want to make an overseas telex call with an international record carrier, you have your choice of RCA, I.T. & T., Worldcom, or anybody else. You would call whatever carrier you chose. They all charge essentially the same rates, of course, but you pay that carrier directly for that charge, and then he in turn would reimburse Western Union, which connects you to the international carrier.

Senator SCHMITT. But there is no equivalent access charge in the international area.

Mr. DUJACK. No; you pay for it. The equivalent is what you pay the local carrier, Western Union.

Ms. SASSEVILLE. I wonder if I could address that question, too.

Senator SCHMITT. Yes, please.

Ms. SASSEVILLE. If an access charge covers, as I believe it should, the actual cost of providing interexchange access, then there is no further necessity for the local exchange to recover additional settlements, because they have recovered the costs and they don't need the further settlements.

The separation is a different question, and the separation is simply the allocational procedure. And under the surcharge procedure that is proposed in S. 611, I think the separations procedure would be required, too.

Under the proposal that I suggested, I am not sure whether it would, because, rather than have formulae that go to SLU factors and SPF factors, you would simply start out with the recognition that the costs of providing interexchange access are equal to one-half of the costs of providing joint and common facilities for the use of either system.

And if the States were participants in this system with the FCC, the State commissions, which now have to determine the costs of providing local service, could determine the entire aggregate statewide costs of providing the joint and common facilities. They could certify those total costs to the FCC. And I am not sure that further separations and procedures will be necessary, certainly not in the detailed degree to which they exist today.

Senator SCHMITT. We'll certainly examine your proposal. I think we probably would get debate over whether it should be 50-50, 60-40, or 40-60. But it's an interesting idea.

Mr. Case?

Mr. CASE. I might suggest, in addressing myself to your question, both method or each methodology has to do with a determination of costs, and some awarding of compensation as a result thereof. One is a separations and settlements procedure, which is a pretty detailed and somewhat complicated method, which, as you know, has worked for years. The other is one which came about during the ENFIA negotiation meetings before the FCC staff. And as you know, those meetings were concluded in a negotiated settlement wherein the other common carriers were to be allowed to connect to the network initially, as I recall, for 35 percent of the jointly used subscriber plant costs involved in connecting them. The second step was 45 percent and the third step 55 percent, recognizing the cost concept.

The obvious question is why weren't the telephone companies allowed to recover all of their costs? The other common carriers simply stated they couldn't afford to do that in the initial stages, and therefore negotiations on a percentage of cost did take place.

So I see no reason why these are not compatible, even though they are different methods of establishing costs.

Mr. STEWART. I see compatibility, also. The present method is a complicated process, but there's a very close analogy to exactly the type of cost distribution methods that one would find in a manufacturing firm, for particular product lines. In our case we're talking about particular service lines. The process looks at recovery of direct costs, then looks at the recovery of joint and common costs, and then looks to recover contributions to overhead.

Now, with every product and service line there's different contributions to overhead. The more profitable ones, of course, get more attention insofar as allocation of resources are concerned in a competitive operation. The least profitable ones, if the resources are finite, are to be dropped. So there's a very close analogy there.

Now, as we look at the access charge, if the direct costs and the joint and common costs are recovered through the access charge, that takes care of that. Then we come back in and we say, OK how are we going to treat contributions. And now we talk about all different methods. One of them is the proposal that S. 611 has, where we limit surcharges. Another is the ENFIA proposal where they look at the contribution element and propose to collect between 35 and 55 percent over a period of time.

My question on ENFIA is the same as Mr. Case's: Why don't we collect 100 percent? But there's a great deal of compatibility there with the access charge proposal.

Senator SCHMITT. Do you have an opinion on what is the best way to administer the access charge? A joint Federal-State board with FCC participating, is that a reasonable one?

Mr. STEWART. I think the industry has done a magnificent job in handling the funds themselves. I do think the FCC needs to have direct oversight over the process.

Senator SCHMITT. Then having a Federal-State-industry board might be the better mechanism, is that correct?

Mr. DUJACK. Excuse me, Senator Schmitt. I may say, I think it's a very good idea that we have some oversight of the process. Basically, now, industry is doing a fine job in handling it.

However, all of the independent telephone companies have to settle with a contiguous Bell company to receive their toll service revenues, and we do not take part in that process.

The existing act and mechanism under section 201 do not allow us to get into that easily.

Senator SCHMITT. I believe we would retain that section.

Mr. DUJACK. I shouldn't say the act doesn't allow us to get in to it. We can have a hearing under section 201 to offer redress to some connecting carrier who thinks he's being too heavily put upon by his contiguous Bell carrier. But to my knowledge, since I've been in the FCC, nobody has ever tried to do that. And we could get involved, of course, with litigation with 1,500 carriers. Of course, you know better than I do.

Mr. CASE. I think the very fact that there has been no action brought before the FCC in this matter speaks for itself. It's working—

Ms. SASSEVILLE. There is something that is not exactly perfect about the system, though. There is a great incentive built in for cost-settling companies to invest in facilities which will be compensated for under the separations formula. And if they have a choice between an investment which is only going to improve service to a rural subscriber and one which will bring in additional dollars in settlements, naturally they will choose the latter.

The cost-settling companies in our state do considerably better than the average settling companies, and in fact some of them, I think, could be described as living in hog heaven.

Senator SCHMITT. Well, in Minnesota, I guess you understand that. I have some very strong family ties in Minnesota. So it's good to see you here today with that particular input.

I wish phone service was better in the rural areas, but we are working on that. That's a major area we are going to have to work on.

I am going to recess the hearing briefly. Senator Hollings will be back and I will be back in a few moments.

[Recess.]

Senator HOLLINGS. Mr. Dujack, you're head of the Common Carrier Bureau of the FCC. With your experience, suppose they made you president of the A.T. & T. staff. How long would it take you to get an accounting system so that you would know what was going on?

Mr. DUJACK. Well, I was involved with some of the initial churnings to get the USOA system going. I don't know what our Bureau schedule is, but I would say at least a good 2 years, starting today. In other words—

Senator HOLLINGS. Without—excuse me—the FCC. I'm just talking about running the company. If you ran any company, it strikes me that you would have to know where the costs were. I know we're not too good at this in our personal lives and we're always coming up short. But I think we have a responsibility, in a tremendous corporation of that kind, with stockholders and stockholders meetings. I would have to get an armored car to take me to the first meeting, so I could protect myself, for one thing to really know the costs, where the profits were, where I was losing, and where I was making profits.

I don't see how anybody intelligently administers as the chairman of the board unless they've got a pretty good cost system. If I were running General Motors, I would know what the costs would be on a Pontiac and the steering wheel would be on a Chevrolet. I think I'd know it pretty well after 20-some, 30-some years. Most all of them come to power after quite lengthy experience.

I just can't understand that they really don't know what are the costs.

Mr. DUJACK. You would, Senator, know your costs in the aggregate. They have a very good accounting system there. They need to know exactly so that when they go to the money market, they know how much to ask for.

However, when you disaggregate costs—because you have to know how much money you are making on service A, service B, service C and service D—which is one of the things USOA would have to do—if we were to have, say, Bell offering several competitive services without separate subsidiaries—then you would have problems.

You get now into the area of philosophy, mythology—

Senator HOLLINGS. You have men of goodwill and intent, and ladies, who would differ as to how it could be allocated. I could understand that. But I'm talking about with a wholly owned subsidiary how they break down these costs.

Mr. DUJACK. Then you've got a fighting chance.

Senator HOLLINGS. You could identify it immediately, couldn't you?

Mr. DUJACK. Yes.

Senator HOLLINGS. And that wouldn't be unusual or burdensome, to have fully, wholly owned subsidiary in order to compete.

Mr. DUJACK. It shouldn't be. I worked with ITT.

Senator HOLLINGS. They did that, and they didn't have any trouble.

Mr. DUJACK. No. On the other hand, those proponents of a uniform system of accounts rather than separate subsidiaries do have a point, because there can be certain, let us say, collusory concatenations—I don't mean to use such big words. You know—you can collude.

Senator HOLLINGS. If I am a chairman, I'm really getting paid from the subsidiary and from the parent company. At least you can put those costs in a particular category and begin to analyze those as to whether they were being used, as you call them, delusory?

Mr. DUJACK. I said collusory.

Senator HOLLINGS. Well, they're delusory to me. But whether they were being used unfairly, in order to avoid competition—Ms. Sasseville, you came up with categorical 50-50 figures. I was really impressed by that. And then you said, but let's study. How do I reconcile that?

Ms. SASSEVILLE. I didn't think you needed to study the 50-50, Senator Hollings. It was the allocation and the determination of what the total costs would be of which the 50 percent would be half, and the changing of the procedures by which the companies would recover their costs, that I think will take time.

For example, if the State commissions were to determine the aggregate of the total costs—we presently hold, oh, I don't know, a dozen cases a year in which we determine telephone company costs. And I'm sure we could speed that up some. But no matter how fast we went, there would be a limit as to how fast or how accurately we could determine what the total costs were in order to say what 50 percent amounted to for interexchange access.

Senator HOLLINGS. I appreciate you helping us, and your testimony has already been very helpful. But I mean, even further, we withheld for a year with Mr. Van Deerlin's bill, watching it and listening to witnesses and presentations made there. We had quite a discussion, of course, along this line, when the Bell bill was presented 3 years ago. And we have studied and studied, and you can see where our witnesses come. And they say, the FCC is really

not regulating A.T. & T. and competition is there, so let's be realistic and be fair and try to lead the way, rather than just react in a negative way.

So some of these could well have been asked by my colleague, Senator Schmitt. But Mr. Stewart, I can't understand why the combination of the basic exchange maintenance program and access charges could fail to provide as much revenue and probably more than you got from your separations. In 1977, you said you applied for 14 percent less, I believe.

Did you calculate the effect of the BEMP on your company in taking into account the access charge which you will be able to place on all connecting interexchange services which would be set to cover all costs of connecting with these—with the services?

Mr. STEWART. Yes; I appreciate your question, Senator. I'll tell you what I did and you can see that the answer to that is no. I look at 1972 through 1977 and I told the accountant, and this was all that he was able to do, is to look at what our corevenues were from separations and settlements for those years, and then recalculate it to determine what the settlements would have been had we gone according to your bill on using the Bell proposal.

What it did not, of course, assume is that settlements or additional revenues that would be received from carriers who are not now paying. And it also did not look at what we would get because they had less than 30 customers per mile. So that information, I suppose, is relatively useless when you look at it from that standpoint.

Senator HOLLINGS. Well now, with respect to the joint board, if you didn't want those funds to be handled by a joint board, as some of the other witnesses have testified, would you elaborate on what you would like to see implemented.

Mr. STEWART. Yes, sir. I think the present system has worked remarkably well insofar as the handling of funds is concerned, and I don't think that's presently a problem within the industry. I do think, though, that there should be oversight by the FCC.

Senator HOLLINGS. That would probably be oversight in both cases. But once you get into the competitive nature, you get the basic exchange maintenance cost that goes to all of them. They have access whether they're competing or not.

So the school system analogy that you used—whether you use the public schools or not—it strikes me that—well, I don't know whether you had a small one. But I can see one of those witnesses having the telephone company handle his separations. We would have assault and battery cases, instead of regular antitrust suits.

Senator HOLLINGS. Mr. Case, why do you believe services provided by an exchange carrier to an interexchange carrier that would not be included in access charge.

Mr. CASE. Senator, I don't believe there's any provision for that, as we understand.

Senator HOLLINGS. They're actual costs, aren't they?

Mr. CASE. They are. But here you have toll ticketing, one plus traffic, for example, investment that's involved in interchange service. It's traffic-sensitive. If you can find a way to get all the costs in, you're right back into the separations process. I guess we have no objection to that, but in our calculations, we believe those costs I mentioned in my testimony are not in the access charge.

Mr. DUJACK. I think it would be reasonable to put that in the access charges.

Ms. SASSEVILLE. And I assumed they were.

Senator HOLLINGS. As you just stated, it's our intention that all these costs are included in the access charge. We agree there's a piece of equipment, Mr. Case, whether a piece of equipment is owned by local companies, performs both toll and local operations, some form of separation costs between the two activities and jurisdiction is necessary.

Our bill envisions—this takes place at a rate hearing before the FCC and the State public utilities commissions. But you seem to think S. 611 abolishes the function of separating costs. Am I understanding you correctly?

Mr. CASE. Yes. As I understand the bill, sir, a separate corporation or separate entity would be formed to perform the toll portion of that service. Some formula would have to be devised to allocate the investment to local service, as opposed to that allocated to the operation of toll.

And we find it even difficult in our present scheme of things, especially with the new technology, digital switching, electronic switches, and the like, to really identify what should be the separated costs.

As a matter of fact, we have committees which are constantly working on that subject. We think it would be very difficult to isolate those costs at this time and to offer toll service especially through a separate subsidiary.

Mr. DUJACK. I might say that that's not my understanding of the bill, the separate subsidiary was meant only for those people who would provide interexchange transmission services.

The switch, which is part of your local exchange facility insofar as it was used to support access by interexchange carrier to your exchange facility, would after separation of function—assign so much cost to the toll service which would go into the access fee, which would be paid by the interconnecting carrier, that is my reading of section 222.

Mr. CASE. Apparently, we have two different interpretations already.

Senator HOLLINGS. Mr. Dujack, you say that you would suggest language be added to the bill which would state congressional policy with respect to the possibility of upward rate pressures upon local exchange services and possibility of remedial action.

Would you elaborate on that, please?

Mr. DUJACK. As I said, in my testimony, Senator, until we get hands-on experience, it is difficult to predict the extent to which the operative philosophy of S. 611, namely, that we price exchange services on costs and put some impetus upon the providers of local exchange service to improve their operations with the addition of technology—may not produce sufficient new revenue to compensate for the decline in the EMF payout.

And I think if one is making this kind of policy, one might have to worry about those people. I can see the possibility that individual companies—I'm not talking about industry—would be seriously hurt.

And it would be useful in those cases, I would imagine, for the Commission to be given some discretion to depart from the formula of administering EMF, the way it is now, to provide remedies to those people.

I think the language should be there if that is what you would want us to do.

Senator HOLLINGS. To give statutory perspective to the joint board, should the general counsel look at that suggestion in light of the litigation involving that independent office's appropriation act fees?

Mr. DUJACK. I haven't seen his testimony.

Senator HOLLINGS. The court held there that the act delegated discretion. The amounts to be collected and the purpose against it was an involved delegation of taxing authority.

I was just wondering whether you see any parallel in that?

Mr. DUJACK. I can't answer that. I'm not an attorney.

Ms. SASSEVILLE. Senator Hollings?

Senator HOLLINGS. I thought Senator Schmitt would momentarily be back. I think we will recess the hearing now. If any of you wish to add anything further, we'd appreciate it.

Ms. SASSEVILLE. I just wanted to respond to your last question. I believe the National Association of Regulatory Utility Commissions has filed a brief on the question of constitutionality of the delegation of powers in the joint board proposal.

Senator HOLLINGS. I see. Well, we'll get a copy of that filing, too. Yes, sir, Mr. Case.

Mr. CASE. Senator, I only had one point that I failed to make in my testimony. And it just seems to me we have what the industry believes, and I think the public believes, to be an equitable method of distributing the toll revenues of this Nation.

What we are attempting to seek here is a way to adequately allow the new entrants into the field, as I see the purpose. It does seem to me that while the ENFIA concept, is certainly a start in that direction I would hesitate to support anything that would allow us to go out into new ground without having a pretty firm hold on that which is here, in order to have the least amount of disruption in the industry as possible.

I do think it is possible under the existing arrangements to provide access charges with the ENFIA concept: I would strongly suggest that you take a good look—that the committee take a good look at that concept.

Senator HOLLINGS. Ms. Sasseville, do you agree?

Ms. SASSEVILLE. No; I don't. I think it depends on the timeframe we're talking about. Today it may well be true, but tomorrow it's not going to be true. And I understand the purpose of this committee is to plan for the future in such a way that even under conditions of competition, we will be able to protect the availability of universal service.

Senator HOLLINGS. Mr. Schmitt, do you have any more questions?

Senator SCHMITT. Yes, Mr. Chairman, just one or two more, particularly on the problem of noninterconnecting interexchange carriers and why they should pay a surcharge.

Would this tend to discourage new technologies by inflating the costs for those noninterconnecting carriers?

Mr. STEWART. Would you like for me to respond?

Senator SCHMITT. Whoever wants to raise their hand.

Ms. SASSEVILLE. I'd like to respond. It is only inflating if you fail to recognize that the alternative for those new technologies is for them to build their own distribution system so that they can offer a complete service from business to business or home to home.

They don't want to do that. All they want to do is offer the portion in effect from board to board. And that system is piggy-backing on the existing system and it's fair that it contribute to the cost of building that system.

We have an example. I think ordinarily it's difficult for us to see that there really are costs involved when an additional unit comes on the system.

We have an example in the small town outside of Minneapolis. That convinced me that there are costs—a community of about 2,000 people with a switchboard about, I think, 8 years old, cross bar and quite adequate. And then a very large national concern moved into that town, which did its business via the telephone and with hundreds of lines, more than hundreds of lines.

And within 3 years, that switchboard has been literally pounded to pieces. And every ratepayer in that local exchange has paid the price with poor service, service that doesn't work, switching that doesn't work properly, so that they don't get connected to the call they want or calls come in and they don't get connected to them.

Now that additional cost——

Senator SCHMITT. If I may interrupt, that is a service utilizing network facilities, right?

Ms. SASSEVILLE. No; it only uses the local exchange—I'm sorry, it does use the——

Senator SCHMITT. It's connecting. What I'm asking about are services such as the new Xerox proposal, which really will be another type of interexchange service but will not necessarily use local exchange facilities. If they were not providing basic voice telephone service, should they pay a surcharge?

Ms. SASSEVILLE. If it doesn't use local exchange facilities at all?

Senator SCHMITT. It's an interexchange service, but it's not interconnecting with the local exchanges.

Ms. SASSEVILLE. I think by definition, an access charge has to mean that the call goes through the local exchange office.

Senator SCHMITT. Mr. Stewart?

Mr. STEWART. I have a problem and that is this. The telephone system in America today provides redundancy for the most important sections, including all of the toll sections of the network.

That means in case part of the system fails, another part takes over and does the job.

In addition to that, the most expensive element that we have to handle in our business, just like in the power companies, is peak load. We have to be able to handle that peak load even if it only comes 1 hour one time a year. And that's expensive.

Now a carrier that comes in and doesn't have to interconnect to us, but competes against us for a piece of the same type of business that we are offering, can then say to the customer that the tele-

phone company becomes a redundant network and in case his less expensive system fails, then the customer can go to the telephone company and use our lines until such time as his lines come back up.

That saves our competitors an enormous amount of money.

Furthermore, from a peak load standpoint, they can also use the telephone system to handle the overflow.

Senator SCHMITT. What if they don't compete? What if they are providing a new service that cannot use the local exchange?

Mr. STEWART. I would have a very difficult time arguing the point if they did not in some manner use the telecommunications network as a redundant system or as an overflow arrangement.

Senator SCHMITT. But presumably, there are some gray areas.

Mr. STEWART. I think there's a lot of gray area.

Senator SCHMITT. Does anybody else have any comments on that question?

Mr. DUJACK. The Xerox question? My comment was going to be just what you said. It would seem sort of absurd for any organization like Xerox, which, in their business plans, say "We're in the high speed document transfer business, period." There may be some voice which is a bonus, but that is not within their primarily intended operations, I believe.

Now if someone, however, with new technology were competing directly with the telephone business without using exchange facilities, I would say it doesn't make good economic sense to have them pay. But, from a social policy point of view, I could see where the local exchange operator may have a reasonable position.

However, I don't see the eventuality, with today's technology, that people would be going immediately and extensively into the voice business, bypassing local loops.

Mr. CASE. Senator Schmitt, I would like to reinforce the opinions of my colleague on the left. I think the word "access" does—is the primary thing here. I would like to, however, point out in this age of computers, the services we render over the switch network, these days we find great massive uses of our extended area service trunks and the like, which is disproportionate to the other uses.

So, we think those people who do connect to the network, however, regardless of whether it's voice, data, high speed link, or anything else, can certainly have an obligation to support the network.

Senator SCHMITT. Finally, I would be interested in some specific examples, if you have them now, or for the record, of the impact that the two bills would have on local rates. It has been argued that the result would be higher rates.

Are there studies to indicate that this would be so?

Mr. DUJACK. I can't cite any quantitative studies. We haven't had time to do them. We'd have to use a crystal ball.

Senator SCHMITT. It's a judgment call.

Mr. DUJACK. Yes; in those areas—we all know the EMF payout is going to go down. It's simply a matter of predicting whether or not, with stimulation of traffic because of lower interchange rates, the people, would or would not experience a revenue shortfall.

It's hard to make that kind of a study.

Senator SCHMITT. Could it be made by utilizing a transition period as an experimental period which would clarify the answer to that question and remedial action could be taken if necessary?

Mr. DUJACK. It's hard to answer. I've never really addressed myself to that point.

You know, a transitional arrangement would be interesting.

Senator SCHMITT. Well, S. 622, of course, envisions transition.

Mr. DUJACK. That's why I made the point, Senator, with regard to S. 611. Basically, in my testimony, I'm saying the same thing. Let's have a transition.

If the commission has some discretion——

Senator SCHMITT. Should it be a fixed time period? We've had a debate on that question during some of our panels. Six years, 10 years?

Mr. DUJACK. I don't think that it should go on forever. I think in 4 or 5 years we'd have some idea. Then if we are going to have discretion in S. 611, we could set up a permanent policy such that, occasionally, when an outlier, so to speak, appears to be really adversely affected, we can do something about it.

Senator SCHMITT. More or less like we did in airline deregulation, where we gave the CAB, some fairly specific discretion, to assist a particular community that was being damaged by the deregulation process.

Mr. CASE. Senator, in specific answer to your question, the studies that our industry has made have assumed that the element of separations and settlements, the so-called contribution, as it's been referred to here, would, in fact, have been reduced or eliminated.

Those studies have been made.

I don't believe that the studies have taken into consideration the competitive effort, additional usage and the like, over the years to see what would happen. I don't believe we have that as an input here.

But the industry does have a substantial data base with which studies not only can be, but are being conducted at all times, and I think there is a way to do this.

For example, I think it was 3 years ago we conducted a study of 6 months duration to try to find an alternative to the present separations procedure. We looked at 19 different alternatives. We did it at a facility located at Dulles Airport. There were seven people, I believe, involved in that total 6-month study. We made computer runs.

Quite frankly, we could not find a procedure or an arrangement that would satisfy what we thought were the desired results of not only the companies, but our customers, that would do the job. And so as a result, we have said that we must stay with the present one until a better one is found. A great deal of effort was put into that study.

I guess we are open to all suggestions, too, but we think that there are some serious misgivings at present—in the present proposal here in S. 611.

Senator SCHMITT. Ms. Sasseville?

Ms. SASSEVILLE. Senator Schmitt, on two points with respect to a timeframe, I think rather than trying to anticipate the future and set a timeframe, we should start the ball rolling with a joint board

and ask for regular reports and follow it along, and when you get to a point where you can see a timeframe that's not pure speculation, then you can set it.

On the question of whether rates are likely to go up or down, I'm very bullish on the communications industry. I also regulate electric and gas utilities. And in comparison to the truly horrendous prospect of rising costs there, looking at telephone problems for me is a pleasure because I see the technological innovation, together with the fact that communications is a human service that responds both to a vital necessity of people, literally life and death situations, and also is open to luxurious use.

So that I see the demand for communications services growing and growing and the cost of providing them being reduced. And I don't believe that rates are going to go out of line.

You know, 20 years ago I never would have believed that Americans would spend the portion that they do if their income to eat in restaurants. And in way, food is like communications, we need to provide a certain vital basic part, but we also have an apparently limitless propensity to use it in luxurious and satisfying ways.

Senator SCHMITT. I had never thought about it before, but there is a correlation between the fast food industry and communications industry in the dispersal of services. These services are available to a wider and wider number of people.

It happened first with communications and the automobile and now it's fast food phenomenon. I'm one of those who believe that that much of our energy efforts should be directed toward dispersed energy availability.

And when I say dispersed, I mean that the location of the energy production is dispersed, either in the local community or in the home. There are a number of technological concepts that are advanced in many respects with communication.

One example is the terminal industry. That has not yet been applied in a dispersed way. I believe we will see the prices go down when we disperse the services. That won't be true for everything, but particularly in rural areas dispersed energy service is going to be much less costly.

Ms. SASSEVILLE. Then when we substitute communications for transportation, we will be able to save even more energy.

Senator SCHMITT. That's going to be tougher. Human beings, what they are, they like to touch. That means they're going to drive.

Mr. CASE. I would not be supporting my industry if I didn't point out the fact that there is a well known chart which compares the disposable income of the country in one graph, the consumer price index in another, and local telephone rates, which, of course, have been relatively flat since 1960.

And I think that bears out a little bit what you say. The only thing I would ask is that my colleague change her thinking so that we would like to have the communications industry bullish rather than bearish.

Ms. SASSEVILLE. Sorry. Did I say bearish?

Mr. DUJACK. Yes; you were asking about studies. We did one worst case study to see what would happen if S. 611 went into

effect in the year 1977, and if in that year, nobody paid out the exchange maintenance fund—which worked out to be \$2½ billion.

We divided that by the number of subscribers there are. And we found a subsidy of \$2.60 a month per person.

So a completely diminished fund may not be catastrophic on average. But, however, again, numbers and aggregates can be misleading. Individual companies could be harmed.

Senator SCHMITT. Is that study available for our record?

Mr. DUJACK. It's about six lines of assumptions.

Senator SCHMITT. You've just given us your study. Is that it?

Let me ask the panel one truly last question: Should Federal policy encourage the States to require telephone companies to adopt measured use pricing and the unbundling of rates?

Mr. CASE. Senator, I have that as an assignment for the SERUC meeting in the NARUC next month to really figure out what I'm going to say.

Senator SCHMITT. Will you send it to the committee when you decide?

Mr. CASE. I would be happy to. But usage-sensitive pricing certainly has to be the order of the day. I mentioned just a moment ago about the massive use of time on our circuitry by computer operators and customers. And some element of time spent on the calls, some element of attempt, and perhaps some element of time of day has to go into the pricing of our service.

Now we have long enjoyed universal service, especially in the residential market, where you can talk as long as you want. And we really lived on the averages.

But it creates some discrepancies. If we are to nail our prices to cost, and that seems to be the trend, then I think we have to recognize that usage-sensitive pricing certainly is in the offing and probably not too far away.

Senator SCHMITT. And by that you mean the more you use, the less you pay?

Mr. CASE. No; the more you use it the more you pay. You pay on an attempt basis, maybe on a minute basis. The unit charge may go down. But, for example, extended area service between two given exchanges, which is a very expensive thing to provide, probably will diminish in its offering and have substituted for it some message unit service which is usage-sensitive.

Senator SCHMITT. I was being facetious. That's the way we got into our conservation or nonconservation problem in energy. There the more you used, the less you paid. That tends to discourage conservation.

Conservation isn't necessarily the problem we face in communications. But I think we do face a possibility of rising rates. Using a message unit basis is certainly something that we should be considering.

Mr. CASE. I think you will find that option should be the order of the day.

Mr. STEWART. I think we need to be very careful about what we call usage sensitive pricing. Usage sensitive pricing makes very good sense for that portion of the plant which is traffic sensitive. It does not make any sense that I can see for that portion of our

plant which is not traffic sensitive. And there is quite a bit of non-traffic-sensitive plant.

Senator SCHMITT. I understand. My question was oriented toward the traffic usage sensitive area.

Ms. SASSEVILLE. I would like to agree with that point, and also to suggest electricity pricing as an analogous thing to consider. And there are many forms of usage-sensitive or time-sensitive pricing in electricity.

I think in telephony, really, we have not explored the full range of possibilities that there might be. I would hate for it to be mandated that States had to adopt a particular form of usage-sensitive pricing which would have the effect of preventing low income and elderly people from using the phone to satisfy their needs.

We've had a study done in the twin city metropolitan area of Minnesota, which indicates that usage-sensitive pricing could cut down on the economic viability of the integrated cities, that telephony and communications help maintain both economic and social viability of the large metropolitan complex.

I do think that it should be an option, and I think there's one place that it definitely should be applied.

We have talked about how access charges would apply to the telephone company. We have not talked about how they would be applied to the interconnecting carrier.

I believe that the charges to the carriers should definitely be usage-sensitive. They should pay on the basis of capacity costs which they impose on the telephone company and on the basis of the volume of their use.

They should not be treated the way a single line residential user is treated. In the residential market, I think, in Minnesota, the telephone is used only about 2 percent of the time. Does that sound right?

Mr. CASE. Yes.

Ms. SASSEVILLE. Obviously, that kind of usage can't be compared with a user who has 100 lines going 24 hours a day. Those factors have to be taken into consideration in charging a carrier under an access charge.

Senator SCHMITT. I believe 25 years from now that low usage rate will have changed a great deal. There's going to be a lot more information flowing into the home than there is today by voice.

Did you have a comment? Anybody else?

Mr. STEWART. I just had one concluding comment; that is that the subject of maintaining average toll rates has not been addressed very much, if at all, and it is one that I would like to have the subcommittee think long and hard about because in Cornelia, Ga., that means a lot to us, a great deal.

Senator SCHMITT. The area where that may have the greatest potential is the lower density population areas.

Mr. STEWART. Absolutely.

Senator SCHMITT. I understand a small Wisconsin telephone company is using both rate systems, hoping to prove to the State commission that they can provide a lower rate to the consumer with the newer type of multiple unit pricing.

So panel, thank you very much.

Thank you, Mr. Chairman.

Senator HOLLINGS. Thank you very much. Let me just add one question. I'm interested in the expertise, obviously, Mr. Case, head of the Separations Committee; you can understand, Mr. Dujack head of Common Carrier; Ms. Sasseville, you sound like you could be a good member of our Federal Communications Commission.

I'll finally get to Mr. Stewart: How did you get lost down in Cornelia?

You seem to know a lot more about this telephone business than somebody in Cornelia, Ga., would know.

Mr. STEWART. Thank you.

Senator HOLLINGS. What's the population of Cornelia?

Mr. STEWART. We're right at 3,000.

Senator HOLLINGS. Boy, you sure know a lot about this business. Thank you all and each very, very much.

Senator SCHMITT. Mr. Chairman, I agree with you on that. When I talk with the managers of telephone operations in small communities, they very often are entirely comparable to what we have seen here today. It's a resource we need to tap more often in New Mexico and elsewhere. It's amazing how close these people watch the industry and are able to provide us with the guidance.

Senator HOLLINGS. Very good. The committee will be in recess until tomorrow at 2 p.m. with the same group.

[Whereupon, at 4 p.m., the hearing was adjourned.]

AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

TUESDAY, MAY 1, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 2 p.m. in room 6226 of the Dirksen Senate Office Building, Hon. Ernest F. Hollings (chairman of the subcommittee) presiding.

Senator HOLLINGS. Good afternoon.

The committee will please come to order.

We are pleased to have this afternoon a radio common carrier panel, with Mr. Louis M. Weinberg from A.T. & T., Mr. Carlos Roberts from the FCC, Mr. George Perrin from Telocator Network of America, and Mr. Travis Marshall from Motorola.

We welcome you.

I think, Mr. Roberts, we will start with you if that's all right.

STATEMENT OF CARLOS V. ROBERTS, CHIEF, PRIVATE RADIO BUREAU, FEDERAL COMMUNICATIONS COMMISSION

Mr. ROBERTS. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, my name is Carlos V. Roberts, and I am chief of the Private Radio Bureau of the FCC.

I am pleased to have the opportunity to comment on this very important legislation. I want to emphasize at the outset that the views I express are my own and do not necessarily represent the views of the Commission.

There are two broad categories of radio services that use the radio spectrum to provide users with two-way mobile communications.

These categories are the wireline and radio common carriers, or RCC's, and the private land mobile radio services. The wireline carriers and RCC's provide radiotelephone and paging services to the general public and are regulated by the Commission as common carriers.

The private land mobile radio services are made up of entities which use radio primarily as a tool for accomplishing some other objective.

Regulation of the private services traditionally has relied on competition to bring the public a wide variety of telecommunications services at a low cost. S. 611 and S. 622 foster this traditional reliance on competition. My experience convinces me that competi-

tion is the best means of insuring that the diverse needs of the public are met and I strongly support this reliance on competition.

Both of these bills would give the Commission the authority to substitute competition for regulation in a number of areas, and I welcome this initiative.

While the proposed legislation will have significant effects on both service categories, I understand that the subcommittee will have a hearing directed to the private services in the near future, and I will restrict my comments at this time to the wireline and radio common carrier services.

As requested by the subcommittee staff, I have reviewed S. 611 with particular attention to its effects on the radio common carrier industry. Presently there are more than 40 States that assert some form of jurisdiction over rates and entry.

Commission administration of the mobile services has been based on a shared responsibility with the States, as congressionally mandated by section 221(b) of the 1934 act.

As I stated earlier, the radio common carrier industry is engaged primarily in the provision of paging and radiotelephone services to the general public. The wireline carriers are also authorized to provide these services, and the frequencies available for this use are divided about equally between the two groups.

There are over 2,500 systems in operation providing paging and radiotelephone services, and they are operated by a mixture of nearly 1,000 radio common carriers and wireline telephone companies.

With that brief description of the industry in mind, I would like to discuss the regulatory environment that is most appropriate for providing radiotelephone and paging services. I believe the procompetitive philosophy espoused in both S. 611 and S. 622 is valid and desirable for these services.

With the exception of cellular systems, which I will discuss later, these services possess no innate characteristics that would necessitate governmental regulation. This being the case, I see no reason why free and open competition should not be the norm in the offering of these mobile services.

In this regard, some parts of the country presently have enough carriers offering services that a fully competitive marketplace would probably result if the heavy hand of regulation were to be removed.

For example, New York and Los Angeles both have upward of a dozen RCC's, in addition to similar services being provided by the local wireline carriers. There are also many smaller cities where a lesser, but still sizable, number of RCC's now operate in what could be a competitive mode.

I know of no reason why paging and radiotelephone services could not be deregulated immediately in these areas.

In addition to those parts of the country where deregulation would be feasible because there already are established a number of would-be competitors, there are other cities with only one or two entities providing services of the type we have been discussing.

Deregulation could also be effected in these areas if two conditions were to exist: There must not be any regulatory barriers to

the entry of new firms into the industry, and there must be frequencies available for new entrants to utilize.

If these conditions prevail, existing carriers who attempt to abuse their market power by engaging in monopolistic practices will be restrained by new entrants, and thus Government regulation may be dispensed with.

In addition to the two competitive environments I have discussed above, there is a third type of situation which must be taken into account. I am referring to those cities where a very small number of firms serve the total market and where there is no potential for new entrants due to the lack of available frequencies.

Because of the immense market power wielded by the existing carriers, and since there is no threat of new entry to restrain the exercise of that power, it is clear that in this instance regulation is appropriate.

If the above scenario represents the optimum near-term implementation of the ideal of full competition in these services—and I believe it does—what are the marketplace conditions needed to bring this situation about?

First, for the reasons I discussed earlier, there should be no barriers to the entry of new firms. As long as there are unused frequencies available, regulators should be prohibited from restricting entry of new carriers. I believe this policy is effectively implemented by S. 611.

Second, an appropriate regulatory body must be authorized to regulate rates in those cases where conditions are insufficient to assure effective competition. I believe the best regulatory forum for such action lies with the States, not with the FCC.

My principal reason for advocating regulation at the State level centers on the fact that paging and radiotelephone services are primarily local in nature, and I believe that if regulation is required, it is best accomplished at the local level.

Additionally, as I mentioned earlier, there are several thousand systems now in operation providing these types of services; and while it is unclear how many systems would require regulation, it may be a significant number.

I don't believe the FCC could effectively and efficiently pass judgment on the large number of different rates and tariffs that would be forthcoming.

However, the States have been filling this function for a number of years, and they are best equipped to carry on in this area.

Reliance on State regulation does give rise to one area of concern, namely whether or not the States will refrain from regulation in those instances where the market conditions are adequate to insure that effective competition will reign.

In order to best implement the competitive mandate of both S. 611 and S. 622, and since the determination of when regulation is needed may be a complex issue, I suggest the FCC be given authority to issue regulations which would specify conditions under which a competitive market is presumed to exist, in which case State regulation would be foreclosed.

Should the subcommittee wish to adopt the regulatory structure I have outlined, few changes would be required in S. 611. If section 102(a) of the bill is intended to effect total preemption of State

regulation of RCC's—and I believe this is the case—then new wording would be required to allow such regulation under circumstances to be determined by the FCC.

Section 204(e) should also be amended to clarify that the Commission can classify a carrier as category I, even though its market share may exceed one-third, if conditions similar to those I have described warrant so doing.

These changes would result in the provision of radiotelephone and paging services under the most competitive environment possible, while still providing the public effective rate regulation in those instances where competition is not presently feasible.

Another major area of concern is the potential effect of S. 611 on the cellular radiotelephone systems that were established by the Commission's docket 18262. These systems depend on an intensive reuse of frequencies to achieve an exceptionally high spectrum efficiency.

The frequency reuse is achieved by developing a number of cells, composed of low power transmitters, that are tied together by a central processing unit. A fully operational cell system will provide enough capacity in 40 MHz of spectrum to serve the potential demand for radiotelephone in the largest market through the 1990's.

The Commission's finding in docket 18262 was that the provision of cellular service was a natural monopoly, based on the economies of scale that could be achieved by a single carrier.

It is estimated that the capital investment for a cellular system is in the tens of millions of dollars. Figures submitted during the course of docket 18262 indicated that the cost of service to the user would be significantly increased if the amount of spectrum available to a carrier was reduced.

This data also showed that the degree of efficient use of the spectrum is substantially improved as the amount of spectrum available is increased. These figures were part of the Commission's rationale for determining that cellular radiotelephone should be a monopoly service, such that only one carrier will be authorized in each market.

Given the fact that cellular radio systems will exist only as monopolies, and also realizing that cellular systems will probably be the principal source of new radiotelephone service for the rest of this century, rate regulation by a Government entity appears to be warranted.

As in the previous discussion of Federal versus State regulation, I believe that regulation at the State level is to be preferred for this type of service, which is essentially local in nature.

Adoption of this policy would also be consonant with S. 611's philosophy of continuing State jurisdiction over exchange services.

Mr. Chairman, this concludes my statement. Thank you for the opportunity of appearing and offering my views.

[The following information was subsequently received for the record:]

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., July 11, 1979.

Hon. HOWARD W. CANNON,
Chairman, Committee on Commerce, Science, and Transportation,
U.S. Senate, Washington, D.C.

DEAR SENATOR CANNON: The following are my responses to the questions you asked in your letter of June 20, 1979.

Question No. 1. You testified that Section 310 of the existing Communications Act needs to be changed if economic tools are to be implemented in spectrum management. Is Section 310 all that needs to be changed for this to happen?

Answer. Section 309(a) presently requires a public interest determination by the Commission prior to a grant of an application filed under Section 308 for a new, modified, or renewed license. However, a change in the current language in Section 310(b) would permit the free transfer of licenses in the private radio services, if the change specifically authorized the commission to grant an application for assignment without making a prior public interest determination, and without disposing of the application as if it were filed under Section 308.

In order to enable the Commission to award original licenses and modify and renew existing licenses without making individual public interest determinations, Section 307 and 309 would also have to be changed. These sections would have to be re-drafted to allow for grants by lottery or auction.

Question No. 3. You note that, even with an amendment to Section 310, " . . . major changes in present FCC rules would be required." Are you confident that those rule changes would take place in the absence of congressional policy directives to stimulate these changes? If not, what would you propose to include in the legislation to insure that these changes do take place?

Answer. I feel fairly confident that these rule changes would be enacted by the Commission without specific congressional policy directives, although I would welcome such guidance. However, it may be desirable to have some language in the committee report that discusses congressional expectations for the Commission's use of economic techniques in spectrum management.

Question No. 3. Mr. Friedland took exception to Section 336 of S. 622. He suggests that, instead of having a license granted automatically after 60 days, the Commission should grant special temporary authorizations. Is there anything stopping the Commission from doing this now? Do we need something in law to allow this to happen?

Answer. The Commission presently has the power to issue special temporary authorizations, and we do so frequently. However, the issuance of special temporary authorizations on a routine basis for all applicants would fail to solve the problem engendered by licensing backlogs. Such an action would simply increase the backlog, as each licensee would have to first receive special temporary authority, and then later a regular license. This process would double the amount of paperwork required to be processed per applicant, and it would worsen the backlog problem, rather than improving it.

Question No. 4. In your testimony recently before the House Subcommittee on Communications, you said: "I personally don't believe that fees for land mobile would be very high, even without the tie-in to television fees, but any such fears could be allayed through the provision in the bill of an arbitrary dollar ceiling on the maximum amount." Now, you have had a lot of experience in this area. Why, based on your experience, do you think that the fees for land mobile wouldn't be very high?

Answer. There are at least three general reasons why I believe the fees for land mobile users would not be very high. First, there is an ample supply of land mobile spectrum available at the present time, due to the 800 MHz reallocation action taken by the Commission. The type of user fees that I would advocate would be scarcity based fees, and as there presently exists little scarcity of land mobile channels in most parts of the U.S., the fees would be fairly low. Second, I believe that new technologies (such as cellular radio, trunked radio systems, and perhaps single sideband) will enable us to make much more efficient use of the presently available spectrum than we are now doing, and thus will extend the availability and capacity of presently allocated spectrum. Again, if fees are based on scarcity, new technology will minimize the amount of scarcity that will be encountered. The third reason why I feel that fees will probably not be very high is because the implementation of user fees based on scarcity could provide a fairly clear signal to the Commission of when the appropriate time to reallocate additional spectrum is reached. Thus, I believe the Commission would be more likely to reallocate spec-

trum to land mobile than it has been in the past, when there have been some questions raised as to need for additional frequencies. If spectrum can be reallocated for land mobile use in an easier manner than has heretofore been possible, this would also contribute to keeping the scarcity value of a land mobile channel low, and thus the corresponding fees would not be very high.

Question No. 5. You mentioned "an arbitrary dollar ceiling". What should that be? Could you give us some suggestions?

Answer. As I stated in my testimony, I don't believe that fees for land mobile users would be very high, and thus I do not believe there is a requirement for a cap on the land mobile fee value. If such a ceiling amount were to be legislatively mandated, the amount would be fairly arbitrary. A possible figure might be \$1,000, with a provision for periodic upward adjustment for inflation.

Sincerely,

CARLOS V. ROBERTS,
Chief, Private Radio Bureau.

Senator HOLLINGS. Thank you very much, Mr. Roberts.
Mr. Weinberg.

**STATEMENT OF LOUIS M. WEINBERG, DIRECTOR OF BUSINESS
EXCHANGE AND MOBILE COMMUNICATIONS SERVICES,
AMERICAN TELEPHONE & TELEGRAPH CO.**

Mr. WEINBERG. Mr. Chairman, members of the subcommittee, my name is Louis Weinberg, and I am employed at A.T. & T. as director of business exchange and mobile communications services. In that capacity, I am responsible for all land, mobile radio telephone services provided by the Bell System.

I would like to thank the members of the subcommittee for this opportunity to be here today.

And in the short time allotted to me, I would like to briefly summarize the testimony that I filed with the subcommittee.

The very fact that this panel has been formed demonstrates the subcommittee's strong interest in land mobile services, and we enthusiastically support that interest. Mobile communications offers an important potential for a dynamic society such as ours, but that potential can't be realized without solving some of the tough problems that the land mobile industry has facing it.

For example, in most major metropolitan areas today, common carriers have long waiting lists of customers whose mobile service needs can't be satisfied due to frequency shortages and also the limited capacity of conventional mobile systems. The FCC has recognized this; and, in fact, in 1968, they instituted an inquiry into the problem. In response to that inquiry, Bell Laboratories suggested the cellular approach that Mr. Roberts has referred to.

We suggested a system that was approximately 20 times more spectral-efficient than the system in use. There is insufficient time to go into a detailed description of the new cellular technology except to say that it is, indeed, spectrally efficient; it has now been technically proven; and it is economically feasible.

The most important thing about it is that it allows superefficient use of the radiospectrum. We are very excited about cellular, and we think we have reason to be.

In fact, we have a developmental trial of the system underway presently in Chicago. We call it Advanced Mobile Phone Service, or AMPS.

Although it is still early in the trial, we are extremely pleased with both the technical operations, as well as customer acceptance.

As cellular service grows and develops, mobile telephone service, or, more accurately, portable telephone service—a phone in your pocket, for example, one that you can carry around with you—could become so practical in terms of price and service quality that in some areas it could be offered on equal terms with the home or business telephone, all of which would someday provide increased diversity and choice to the everyday telephone user, in local exchange communications. To allow the public increased diversity and choice through competition seems to me to be one of the prime objectives of both Senate bills.

In the mobile field, of course, competition has been a fact of life since the very beginning. The membership on this panel today attests that there has been vigorous competition.

The FCC has followed a policy of licensing both radio common carriers, or RCC's, as well as wireline companies or telephone companies, to render mobile phone service.

In 1949, when it made its first permanent allocation of land mobile radio frequencies, the FCC expressly stated that it was assigning separate radio frequencies to RCC's and telephone companies in order to encourage the development of competing systems, techniques, and equipment.

The FCC has continued to follow this policy through the years. We support that policy. We favor freedom for all competitors in this market, including the Bell System, to promote existing services, develop new technology, and provide the best possible mobile telecommunications to the public.

Let me just briefly address a few specific items relating to the proposed bill, items that are more thoroughly covered in my filed statement.

We endorse the provisions in S. 611 that create a temporary national commission on spectrum management. It is our view that such a commission would provide the best means for a needed overall review of spectrum matters.

Further, we strongly endorse section 502, which provides membership on that commission by representatives of Government, industry, and the public. Such a broad range of membership we think will ensure that all interested parties have a meaningful voice in the Commission's recommendations.

We do suggest, however, that the frequency allocation provisions of S. 611 would be more effective if they borrowed an idea from S. 622. Section 336 (b) and (c) of S. 622 provide for the automatic grant of private or nonprivate carrier applications unless the FCC acts on the application within 60 days.

We suggest that the provision be expanded to include both private and common carrier land mobile frequency assignments, which brings me to the subject of spectrum fees.

S. 611 would authorize the FCC to impose spectrum utilization fees based upon fair market value of the benefit conferred for the purpose of encouraging spectrum efficiency. We do oppose such fees.

First, we believe that fees are unnecessary to achieve spectrum efficiencies. Such efficiencies can and have been achieved by carriers who have independently and voluntarily developed technology to compensate for the natural scarcity of spectrum sources. Exam-

ples abound. AMP's, that I've just discussed, comes to mind immediately. In addition, on our TD-2 and TD-3, point-to-point microwave ridge, we increased them from a capacity of 480 channels back in 1948 to 1800 channels today.

Further, a single sideband system was developed in the 6 megahertz, point-to-point system to increase their capacity from 1,800 channels to 6,000 channels.

Further, such fees, under the bill, would only apply to commercial users, users of only about 30 percent of the available radio spectrum.

In addition, fair market value is impractical as a standard in the land mobile field, and I believe will lead only to continued litigation. It is somewhat similar to the value to the recipient standard, codified in the FCC current authority to impose fees.

The FCC's attempt to implement that standard has resulted only in litigation, culminating in the 1976 decision in which the court invalidated the FCC's entire fee schedule.

One last brief point. We would recommend amending the definition section of the bills as they relate to exchange telecommunications area and local telephone exchange. Mobile radio service has its own geographic area, covering a community of interest, notwithstanding local telephone exchange boundaries. The definition section should be clarified to reflect this.

This concludes my remarks, Mr. Chairman.

And, once again, I would like to thank the subcommittee, and I will be happy to answer any questions.

[The statement follows:]

STATEMENT OF LOUIS M. WEINBERG ON BEHALF OF AMERICAN TELEPHONE & TELEGRAPH CO.

INTRODUCTION

Mr. Chairman, Members of the Subcommittee, my name is Louis M. Weinberg. I am employed by the American Telephone and Telegraph Company (AT&T) as Director of Business Exchange and Mobile Communications Services. In that capacity I am responsible for the land mobile radiotelephone services provided by the Bell System to the general public, including the Advanced Mobile Phone Service (AMPS) cellular system presently in developmental operation in the Chicago metropolitan area.

The purpose of my statement is to provide the Subcommittee with the Bell System's comments on the portions of Senate Bills 611 and 622 which concern spectrum management and common carrier land mobile radiotelephone service. In addition, I want to address Section 106 of Senate Bill 611 which, unlike Senate Bill 622, would authorize the Federal Communications Commission (FCC) to impose spectrum utilization fees on land mobile common carriers and certain other commercial radio spectrum licensees.

Before discussing the foregoing, however, I want, first, to thank the Subcommittee for the opportunity to appear before it and, second, to state that the Bell System supports the interest demonstrated by the Subcommittee in connection with land mobile services.

THE IMPORTANCE OF LAND MOBILE SERVICES

Land mobile is important because we believe that such services will play a vital role in fulfilling this nation's present and future telecommunications requirements. There is a proven public need for new and additional common carrier land mobile services. Moreover, we are confident that, in the future, the communications requirements of people on the move will continue to increase. Nonetheless, because of the scarcity of spectrum and the limitations of conventional land mobile systems,

the public need for such services cannot be met without the implementation of new technology.¹

We in the Bell System believe that we have such a technology in the form of our AMPS cellular system which promises to provide a spectral efficient, low cost, nationwide mobile radiotelephone system of equal quality to the service presently available on the landline telephone network. In the AMPS system the mobile service area is divided into geographical units called cells. Each cell is served by its own radio and control equipment and is allocated a set of frequencies, with neighboring cells assigned different frequencies to avoid interference. Cells sufficiently far apart, however, can simultaneously use the same frequencies, allowing reuse of each channel for different conversations many times in a given service area.

The cellular approach eliminates the need for high-powered radio transmission by carrying the conversation over regular telephone lines from, or to, the cell site nearest the mobile customer. Using low power, the cell site completes the call by radio transmission covering only the small area where the vehicle is traveling. As a vehicle moves from cell-to-cell, sophisticated electronic equipment will transfer the call to another cell site. This automatic sequence maintains service quality throughout the conversation without interruption.

The FCC has found cellular systems such as AMPS to be "... the only proposal now before us which offers the service compatibility and spectral efficiency needed to achieve our objective of a nationwide, high-capacity radiotelephone service."² Moreover, the Bell System developmental AMPS trial in Chicago is now in operation and it has proven to be technically feasible and responsive to a significant public demand for such service. Thus, we believe that the system is the harbinger of a future potential for land mobile service. Indeed, cellular systems such as AMPS may some day become competitive with basic exchange service. Certainly, cellular service would free the consumer from his dependency on a stationary telephone location and through the evolution of portability would enable him to carry his personal telephone wherever he goes.

COMPETITION IN THE LAND MOBILE AREA

The Bell System supports the stated intent of both Senate Bills to foster competition in the telecommunications market, where such competition is in the public interest. In this regard, we point out that the common carrier land mobile service market has always involved substantial, vigorous competition. From the outset the FCC has followed a policy of licensing both Radio Common Carriers (RCCs) and telephone companies to render mobile radio service. In 1949, when it made its first permanent allocation of land mobile radio frequencies, the FCC expressly stated that it was assigning separate radio frequencies to RCCs and telephone companies in order to encourage "the development of competing systems, techniques, and equipments."³ The FCC has continued to follow this policy in subsequent proceedings for the assignment of additional frequencies for mobile radio.⁴ Moreover, in *General Telephone Co. of California*, the FCC reviewed its policy of licensing both RCCs and telephone companies and concluded that its policy had "proved to be salutary..."⁵

Again, the Bell System fully supports this policy. We favor freedom for all competitors in this market, including the Bell System, to promote existing services, develop new technology and services, and provide the best possible mobile telecommunications to the public.

SPECTRUM MANAGEMENT

For the reasons set forth below, the Bell System believes that the subject Bills will contribute significantly to better spectrum management. Moreover, with certain modifications, the Bills would lessen regulatory delays in land mobile frequency assignments and, most importantly, encourage rapid implementation of new and improved land mobile technology.

With regard to spectrum management, we support the provisions of Title V of Senate Bill 611 which would create a temporary National Commission on Spectrum

¹ Indeed, in many metropolitan areas we have substantial numbers of requests for mobile service which cannot be met because of the limited capacity of present systems. See, Statement of Dr. Morris Tanenbaum on behalf of AT&T, filed on September 20, 1977 with the Subcommittee on Communications of the House Committee on Interstate and Foreign Communication, at pp. 6-11.

² In *Re Illinois Bell Telephone Company*, 63 FCC 2d 655, 657 (1977).

³ In *Re General Mobile Radio Service*, 13 FCC 1190, 1218 (1949).

⁴ See, e.g., Second Report and Order on Channel Splitting, 16 Pike & Fischer R.R.2d 1602, 1604 (1958).

⁵ 21 Pike & Fischer R.R.2d 957, 963 (1963).

Management to recommend improved allocation, assignment and authorization procedures. Such a Commission would, in our view, provide the best means for a needed overall review of such matters. Further, we strongly endorse Section 502 of Title V which provides for membership on the Commission by representatives of government, industry and the public. Such a broad range of membership will, to the extent possible, insure that all interested parties have a meaningful voice in the Commission's recommendations.

In connection with private, i.e., non-common carrier, land mobile frequency assignments, Section 336(b) of Senate Bill 622 provides for the automatic grant of land mobile frequency assignment applications unless the FCC acts on such applications within sixty (60) days of the filing. The Bell System supports this provision, but suggests that it be expanded to include both private and common carrier land mobile frequency assignments.

Expansion of the provision in the manner suggested above would be desirable because it would minimize regulatory delay and allow for rapid implementation of new services and technologies. Moreover, it would in no way inhibit the FCC from fulfilling its fundamental obligation to the public interest. First, as stated in Section 336(b), the applicant would be required to attest that its proposed use of the frequency has been coordinated with other licensees in the geographic area. Second, the licensee must demonstrate that it is eligible to use the frequency and that the licensee's use will be in compliance with applicable FCC regulations. Finally, the FCC would retain the power to deny the application, or if necessary, revoke the license even after expiration of the sixty day statutory period.

DEFINITION: EXCHANGE TELECOMMUNICATIONS AREA

We want to call the Subcommittee's attention to the fact that in defining the phrases "exchange telecommunications area" and "local telephone exchange," neither Senate Bill appears to recognize that a land mobile service exchange is not necessarily coextensive with the local telephone service exchange in the same geographic area. We do not believe that the Bills are intended to imply that such exchanges are to be coextensive. Nonetheless, to remove any possible ambiguity, we suggest that the definition of exchange area be clarified to indicate that the boundaries of land mobile exchanges may be different than those for exchange telephone service.

SPECTRUM UTILIZATION FEES

Section 106 of Senate Bill 611 would authorize the FCC to impose spectrum utilization fees based on the "fair market value" of the "benefit conferred," presumably for the purpose of encouraging spectrum efficiency. The Bell System opposes such fees because, in addition to the specific objections mentioned below, the standard adopted for determining the proposed fees would serve only to continue the seemingly endless litigation that has been endemic to the subject of FCC fees.

First, the fees are unnecessary to achieve spectral efficiencies. Such efficiencies can and have been achieved by carriers who have independently and voluntarily developed technology to compensate for the natural scarcity of spectrum resources. Further, the FCC's existing rulemaking powers have been frequently utilized effectively to impose spectrum efficiencies through rigorous technical and engineering standards.

Second, the proposed fees would be inflationary because, inasmuch as the fees will add significant cost to the provision of commercial service, the rates paid by the public will necessarily increase. There does not appear to us to be any justification for imposing such costs on commercial licensees who utilize only approximately 30 percent of the available spectrum while other users are exempted under Section 106(a).

Third, and most importantly, the standard adopted for the proposed fee—i.e., "fair market value" of the "benefit conferred"—will lead only to continued litigation. The standard is similar to the "value to the recipient" standard codified in the FCC current statutory authority to impose fees.⁶ The FCC's attempt to implement this standard has resulted only in litigation, culminating in the decision in *Electronic Industries Association v. F.C.C.*, in which the Court invalidated the FCC's entire fee schedule.⁷ Under such circumstances, it is beyond doubt that imposition of a similar standard for FCC fees, as suggested by Senate Bill 611, will solve nothing and, at best, lead only to even further litigation.

Instead of spectrum utilization fees based on standards such as "benefit" or "value," the Bell System suggests consideration of the approach taken in Senate Bill

⁶ See, Independent Offices Appropriation Act of 1952, 31 U.S.C.A. § 483(a).

⁷ 554 F. 2d 1109 (D.C. Cir., 1976).

622, i.e., fees payable based solely on the regulatory costs incurred by the FCC in the licensing process. Such fees would be clearly easier to determine and implement, less subject to controversy. Moreover, they are less likely to result in adverse litigation inasmuch as a similar FCC fee schedule, i.e., the cost schedule in effect prior to 1970, was considered and affirmed in *Aeronautical Radio, Inc. v. United States*.⁸

CONCLUSION

In summary, the Bell System supports and encourages the interest shown by the Subcommittee in land mobile services. We believe that these services, especially AMPS, have a vital and significant role in the nation's telecommunications future. They clearly deserve Congress' full and exhaustive attention. We also support the provisions of Senate Bills 611 and 622 concerning spectrum management.

We do, however, suggest that in order to promote technological development and lessen regulatory delay, the provisions of Section 336(b) of Senate Bill 622 be expanded to include common carrier land mobile frequency assignments. Likewise, to avoid ambiguity, we suggest that the definition of exchange area be clarified to indicate that the boundaries of a land mobile exchange may be different than those for local exchange telephone service in the same geographic area.

In addition, we support the FCC's policy to encourage competition in the land mobile area. We ask only that all carriers, including the Bell System, be allowed to participate fairly and fully in this competition. Finally, for the reasons given in this Statement, we oppose the spectrum utilization fees proposed in Senate Bill 611. We suggest, instead, consideration of license fees based solely on the regulatory cost of the licensing process.

Senator HOLLINGS. Very good, sir.

And next, Mr. Perrin.

STATEMENT OF GEORGE M. PERRIN, PRESIDENT, TELOCATOR NETWORK OF AMERICA

Mr. PERRIN. Mr. Chairman, my name is George M. Perrin. I am the president of General Communications Service, a radio common carrier providing car telephone and pocket paging service to more than 32,000 subscribers in the States of Arizona, California, Florida, Georgia, Missouri, and Texas.

I am also president of the Telocator Network of America, the national council of the radio common carrier industry, on whose behalf I am appearing today.

Last Thursday, John Palmer discussed the core issues raised by S. 611 and S. 622, as we see them. My statement is intended to supplement his earlier testimony. We have prefiled a statement with the subcommittee, which I ask be received in full for the record.

This afternoon, I would like to highlight our position on various matters addressed by the bills which affect the radio common carrier industry.

As one of the industries directly and substantially engaged in "non-broadcast commercial uses" of the radio spectrum, radio common carriers obviously would be required to pay the public resource or other type of spectrum fee authorized in any new legislation.

We recognize that the nature and scope of any such fee is one of the principal differences between S. 611 and S. 622, and that further consideration will be required to resolve this difference.

However, Telocator was greatly encouraged by Senator Hollings' remarks last Thursday to the effect that the phrase "fair market value to the benefit conferred," which is the legal basis in S. 611

⁸ 335 F. 2d 304 (7th Cir., 1964), cert. denied, 379 U.S. 966 (1965).

for determining a fee schedule, is basically intended only to cover the operating budgets of both the FCC and NTIA.

As we understand the Senator's position, S. 611 is not intended to authorize the Commission to generate revenues in excess of the budgets of the FCC and NTIA.

Nevertheless, we believe that S. 611 would grant too much discretion to the Commission in establishing a fee schedule. Even the clearest legislative intentions have a way of being abused or at least distorted over time. A fee schedule grounded legislatively in the language of S. 611 would be a tempting target for just such an occurrence.

Accordingly, if the Congress decides to impose fees designed to recover more than the Commission's direct and indirect costs of regulation, we believe it should explicitly tie the nonbroadcast fees in some equitable manner to the fees on UHF television stations, in somewhat the same manner as S. 611 ties the UHF fees to the fees for VHF stations.

As we understand them, both S. 611 and S. 622 clearly recognize that the new competitive environment in telecommunications which they would create also must be one in which fair competition exists.

However, we believe that attaining such a goal in common carrier mobile communication requires some further refinement in the bills.

The bills are appropriately concerned with fostering the development of competition to A.T. & T. in markets where A.T. & T. has historically been the monopoly provider of service, and in which A.T. & T. still is the overwhelmingly dominant entity despite competitive entry in recent years.

But this is not the problem in common carrier mobile communications; not even the largest of the 550 or so radio common carriers nationwide serves as much as 5 percent of the total industry subscriber population.

Instead, the threat that exists in our case is that the FCC might permit the substantial and effective existing competition to be destroyed through improvident and misdirected decisions.

The FCC has been preoccupied in recent years with attempting to promote competition in telecommunications markets that A.T. & T. dominates. In the absence of an explicit mandate to the contrary, the FCC could easily interpret a new, procompetitive legislative charter to permit the domination of the presently competitive radio common carrier industry by one or a few large entities.

This danger is especially acute because the FCC is now in the process of opening vast new bands of spectrum to the land mobile community to provide for its future growth through the end of this century.

Stated another way, under an environment of relatively unfettered entry created by S. 611 and S. 622, we are very concerned that the FCC would not distinguish between its historically competitive thrusts, which look toward breaking down A.T. & T.'s monopolies wherever feasible, and massive entry into our industry, which actually could have severe anticompetitive consequences.

These concerns specifically embrace the potential for vertical integration of the radio equipment manufacturers into the carrier business, as well as the potential for domination of our industry by large companies now engaged in related telecommunications activities. But they apply with special force in the case of A.T. & T.

Much attention is paid in the bills to assuring that A.T. & T. is allowed to compete in any business it chooses. We have been competing directly with A.T. & T. for many years, and—with due respect to my friend Lou Weinberg—we have been victims of A.T. & T.'s competitive misconduct for an equal length of time.

I have given a few examples in my prepared statement; I could give many more. A.T. & T.'s misconduct toward radio common carriers has been substantial in the past; it continues to date; and we see nothing to indicate that it would abate in the future.

Therefore, we must ask, at what cost to the public is it worth the limited, incremental benefit, if any at all, arising from A.T. & T.'s competitive presence in mobile communications?

Is the incremental benefit worth the enormous cost of maintaining an elaborate Government apparatus to try to convert A.T. & T. into a fair competitor in mobile communications?

It is one thing to maintain such an apparatus to foster genuine competition in markets which A.T. & T. has historically served on a monopoly basis. But that is not the situation in mobile communications: genuine, effective competition already exists in mobile communications.

Is the incremental benefit worth the cost to the public in the form of cross-subsidization of A.T. & T.'s competitive service activities from its monopoly ratepayers' pockets?

And is the benefit worth the cost of the substantial litigation against A.T. & T. which radio common carriers must necessarily incur in order to stay in business, and which the public ultimately pays for in the form of higher rates?

Accounting procedures and fully separated entity concepts are attractive and necessary regulatory tools—but they are not absolute cures. Even if they could be administered perfectly, which they cannot, they can be largely defeated in various ways.

In any event, the blunt fact is that because of its vast monopoly service base, A.T. & T. has incredible staying power, and could tolerate a much lower return in a competitive service for a much longer period of time than could any normal competitor.

A.T. & T. did not attain its overwhelming dominance in telecommunications, and the substantial competitive advantages derived therefrom, purely through its own efforts to serve the public.

Rather, the collective weight of the Federal and State governments has been used to shield it from competitive intrusions for many years while it accumulated its vast economic and financial power.

Since this Government overtly assisted A.T. & T. to attain its present position, we do not think it at all unfair or unreasonable for the same Government to impose some overt restrictions on A.T. & T.'s conduct at the time the competitive shield is removed.

The radio common carrier industry is particularly vulnerable to competitive abuse by A.T. & T. in the new environment contem-

plated by S. 611 and S. 622—notwithstanding that substantial, effective competition already exists in the industry.

Absent this continuous anticompetitive threat which A.T. & T.'s presence would create, this substantial, effective competition would continue and be enhanced as a matter of course as new spectrum bands are opened.

Under these circumstances, we respectfully submit that the limited, incremental benefit to the public, if any at all, from allowing A.T. & T. to expand its presence in the mobile communication services is far outweighed by the various direct and indirect costs to the public arising from its competitive misconduct.

Therefore, until such time as A.T. & T. restructures itself to be able to compete fairly in the ordinary course of events, or until the market has grown to the point that A.T. & T.'s presence does not raise substantial anticompetitive dangers, the Congress should explicitly prohibit A.T. & T. from licensing any new mobile radio systems unless the FCC determines that the public otherwise would not be adequately served.

These are some of the problems we have identified. Other equally important matters, such as the rural telecommunications development program proposed by S. 611, are discussed in my prepared statement. We will propose amendments to the bills which specify our concerns and suggestions.

Thank you for allowing Telocator Network of America this opportunity to express its views on S. 611 and S. 622.

[The statement follows:]

STATEMENT OF GEORGE M. PERRIN ON BEHALF OF TELOCATOR NETWORK OF AMERICA

Mr. Chairman and members of the subcommittee, my name is George M. Perrin. I am President of General Communications Services, Inc., a radio common carrier (RCC) providing car telephone and pocket paging service to more than 32,000 subscribers in Phoenix, Flagstaff and Tucson, Arizona; St. Louis, Missouri; Atlanta, Georgia; Jacksonville, Florida; Midland-Odessa, Texas; and San Diego, California.

I am also President of Telocator¹ Network of America, the national council of the RCC industry, on whose behalf I am appearing before you today. We appreciate the opportunity to discuss S. 611 and S. 622 from our perspective as members of the land mobile radio community.

With me in the hearing room are Mr. Thomas H. Lamoureux, Executive Director of Telocator, and Mr. Kenneth E. Hardman, whose firm is general counsel to Telocator.

GENERAL

Last Thursday, John Palmer appeared on Telocator's behalf to discuss its principal concerns with respect to S. 611 and S. 622. He requested that RCCs be classified as interexchange carriers for regulatory purposes, if the jurisdictional change between the states and federal government is enacted as proposed by the bills. Further, he requested that explicit safeguards be included in any such legislation, designed to maintain competitive industry structures where effective competition presently exists, in addition to those safeguards now in the bills primarily designed to foster competition in those markets where A.T. & T. has already established an overwhelmingly dominant presence.

My statement today is designed to supplement our earlier testimony by discussing related issues pertaining to S. 611 and S. 622 which arise from the RCC industry's particular perspective both as a member of the land mobile radio community and as domestic common carriers.

¹ Trademark of Telocator Network of America.

SPECTRUM USE FEES

A principal difference between S. 611 and S. 622 which directly affects the RCC industry lies in the nature of the radio licensing fees which each bill would authorize the Commission to establish and collect. S. 622 would substantially affirm existing law by limiting the Commission to recovering its direct and indirect costs of regulating the entities subject to its jurisdiction. On the other hand, S. 611 would establish a fee schedule based upon the "fair market value of the benefit conferred" by the various licensees it issues.

In the case of the broadcast services, S. 611 establishes explicit standards for computing the fee level. However, in the case of all other radio services, the Commission would be given a general mandate to develop an appropriate fee schedule within 360 days of enactment of the legislation, and to use methods such as auctions, sealed bidding, etc., to determine the value of any license granted.

Telocator strongly opposes the amorphous nature of the fee schedule provisions proposed by S. 611 for non-broadcast commercial spectrum users. Obviously, as one of the industries engaged in "non-broadcast commercial uses" of the spectrum, we are not going to be enthusiastic about any proposed new tax which would raise our costs of doing business. Further, as expressed at some length elsewhere,² we have substantial doubts—as do the authors of S. 622—as to the intellectual and philosophical propriety of fees based upon some perception of unjust private enrichment.

We are keenly aware than many who support such fees believe that a license to use a given portion of the spectrum is a gratuitous government largesse. However, we believe it should be viewed more properly in our case as an unusual requirement for conducting a business that most businesses do not have to face. In reality, with the grant of a license, we have obtained little or nothing more than the right to compete for the public's business along with the telephone company and any number of others. Moreover, we have not been persuaded that the orderly management of the spectrum, which is the purpose of the licensing process, is conceptually any different than other governmental functions which are performed for the public at cost—such as maintaining armed forces for our common defense.

Nevertheless, our principal objection to section 106 of S. 611 is the substantially unfettered discretion it would grant to the Commission in the non-broadcast services, and the corresponding potential for abuse and anticompetitive mischief which it would create. Absent extremely careful controls, devices such as auctions, which are nominally designed to help measure the "fair value" of spectrum, actually could be used by the established economic and financial interests to monopolize the spectrum and further concentrate economic power in this country.

It was precisely to prevent this kind of anticompetitive conduct that the FCC originally made separate allocations of spectrum in 1949 to the telephone industry and the yet-to-be-established RCC industry. In our view, section 106 of S. 611 would turn its back on this important lesson of history, not only with respect to the RCC industry, but also with respect to all forms of commerce in the United States which employ radio systems in the private radio services. We do not believe such a provision can be reconciled with the otherwise pro-competitive thrusts of S. 611 and S. 622.

Accordingly, should the Congress determine that some form of public resource fee should be imposed for non-broadcast commercial uses of the spectrum, it should also, at a minimum, establish explicit ceilings for such fees in the organic legislation itself, and not just delegate the matter to the informed discretion of the Commission. To accomplish this, we believe it would be workable to tie the non-broadcast fee in some equitable manner to the fees for UHF television broadcasting stations, much as the fees for those stations are tied to the fees for VHF television stations.

APPLICATION BACKLOG

Section 301 of S. 622 recognizes and specifically treats through legislation, by addition of a section 336 to the Communications Act of 1934, the problem in the private land mobile radio services of a growing backlog of license applications pending action at the Commission. S. 611 does not propose a specific legislative solution for this problem, but creates a Spectrum Management Commission to study and make recommendations concerning this and other matters related to spectrum utilization.

The RCC industry also has a severe problem with application backlogs at the Commission which we believe warrants special legislative attention. The licensing process in the common carrier land mobile service necessarily is more complex than in the private services, and, therefore, adoption of something like the automatic-

² See, e.g., Comments of Telocator Network of America, In the Matter of Fee Refunds and Future Fees, FCC Gen. Docket No. 78-316 (1 February 1979).

grant approach proposed by S. 622 would not be prudent in the case of the common carriers. However, our study of common carrier licensing³ persuaded us that the basic problem is the lack of Commission incentive to adequately administer the process—not in the process itself. Thus, we believe that a simple deadline for Commission action, such as proposed or adopted for other types of Commission decisions, should solve the problem.

Accordingly, we request than any legislation enacted contain a new paragraph (f) in section 309 of the 1934 Act (redesignating existing paragraphs (f) to (h) as (g) to (i), respectively) reading substantially as follows:

“(f) In the case of any application for an instrument of authorization in the common carrier services, the Commission shall grant such application without a hearing or designate such application for hearing, as appropriate, within 180 days of the date such application is filed.”

RURAL TELECOMMUNICATIONS DEVELOPMENT

Sections 229 through 234 of S. 611 would provide for a comprehensive program of planning and development of telecommunications and other services in small towns and rural areas of our country. The program is designed to assure that all of our citizens share in the societal benefits which advancing technology have brought about and promise for the future, while recognizing that the economic base of non-urban areas may not be sufficient to bring this about through the normal course of marketplace interaction. In addition to providing for comprehensive planning, the program proffers the assistance of the federal government, through the REA loan program, to provide direct financial resources to those entities engaged in extending the benefits of technological advances to rural America.

In Telocator's view, this is an extremely important program which is critical to the success of any restructuring of domestic telecommunications along the lines of S. 611 and S. 622. We cannot emphasize too strongly that a substantial portion of the progress which has been achieved in the last few years is likely to be jeopardized unless in the new legislation Congress pays special attention to the particular circumstances in our small towns and rural areas.

Mobile communications has a special role to play in rural America. Because of the relatively low population density in such areas, many business and professional persons spend a substantial amount of their time in an automobile (or truck) traversing a wide area in the ordinary course of their activities. For such persons, mobile communications technology may be the only way they have to efficiently keep in touch and conduct their affairs.

Moreover, in some areas of the country, radiotelephone service is the only telephone service available. As expensive as a radiotelephone unit may seem, it can be more economical than the cost of covering a highly dispersed population over a wide area with wireline technology. For these reasons, our most active service areas per capita often are located in small towns and rural areas.

Ours is a high technology industry; we are very much aware of the capital investments required to bring to the public the sophisticated mobile communication services that have been developed by our suppliers. Although many of us originally got into the carrier business as a sideline to a telephone answering service or two-way radio sales and service business, this is no longer sufficient. Instead, if the public is to have available to it the sophisticated mobile communication services which are technologically feasible, and to which the public is entitled, RCC services must be developed on a par with other telecommunications services.

This has special implications for small town and rural America, and for the development program contemplated by S. 611. In such areas, the availability of sufficient spectrum ordinarily is not a problem, since allocations for particular services must be geared to also serve the needs of large urban areas. Rather, the basic problem is having an economic base sufficient to support the various services desired.

Many of our members—particularly the smaller carriers—serve just such areas. Presently, where effective state regulation exists, they have been encouraged to invest in sophisticated technology in order to provide their services, knowing that if they did so their economic base would not be fragmented to the point that it could not support these investments. One of the problems with the environment that S. 611 and S. 622 could create is that these incentives for investment could be eliminated without being replaced by a reasonable substitute.

³ See Comments of the National Association of Radiotelephone Systems, In the Matter of Regulatory Policies and Procedures for the Domestic Public Land Mobile Radio Service, FCC Docket No. 20870 (5 Nov. 1976).

One can go into the RCC business more or less on a "shoestring" and provide service—albeit less than adequate service by contemporary industry standards. The point, however, is that given the ready availability of frequencies in small towns and rural areas, any number of "part-time" operators could go into the business with a modest investment. In such case, the economic base could be fragmented to the point that while everyone could make a living, there would be no significant accumulation of capital in the business and on real incentive on anyone's part to invest in technologically advanced plant facilities for the operation of the services.

The industry certainly would not like to see such a perverse result; and we do not believe the Congress would want it either. For this reason, we strongly support the rural telecommunications development program contemplated by S. 611, and we would expect the RCC industry to be a significant part of it.

One final point on this subject which should be mentioned briefly. At present, RCCs are excluded from the REA loan program, while their neighboring (or competitor) independent telephone company has full access to it—both for wireline facilities and for mobile communication facilities. That is, exactly the same plant which an RCC must finance through conventional commercial sources can be financed by its neighboring or competitor independent telephone company through REA at a cost far below that available to an RCC.

By opening up the loan program to all entities engaged in telecommunications services, S. 611 would remove an anachronistic and basically indefensible discrimination against RCCs who are attempting to serve the same type of public independent telephone companies.

TRANSITION PERIOD FOR RCC'S

The rural telecommunications development program, if included in any reforms enacted, should go a long way in resolving our members' concerns in making their adjustment to the new environment which would be created by the bills. John Palmer addressed this matter last Thursday in his presentation to the Subcommittee, and I will not reiterate his testimony here.

However, I would like to add my support to his observations and note that we will be making some specific suggestions to the Subcommittee after our staff has had a chance to explore in more detail the problems involved.

FAIR COMPETITION

Both S. 611 and S. 622 express their intentions in various ways that the new competitive environment which they would create necessarily must be an environment in which fair competition exists. Telocator wholeheartedly agrees that attempting to create full competition without an equal emphasis on the structure to attain fair competition would not be in the public interest. However, in this respect, we submit that further refinement of the bills is required in order to properly protect conditions of fair competition in the RCC industry.

First, as a general matter, specific safeguards must be incorporated in order to prevent the industry from being dominated by one or a few large entities. With the exception of AT&T, as to which I will say more later, the common carrier mobile communications industry now has a highly competitive structure. Not even the largest of the 550 or so RCCs nationwide serves as much as five percent of the total industry subscriber population.

But with relatively unfettered entry into the business, combined with large new allocations of spectrum being made available for the industry's future growth, the existing industry structure could change radically and in very short order. A large national company with an established identity in a related field could seek to acquire a dominant position in the industry by blanketing the FCC with license applications in the top 30 markets or so and then could leverage its position in the related field into a dominant position in the mobile communications carrier business.

Such conduct would raise monopolization issues under the Sherman Act, and possibly other issues under different antitrust statutes as well. The FCC has been preoccupied in recent years with attempting to promote competition in telecommunications markets that AT&T dominates. As a result, in our view, it has unfortunately lost (or never sufficiently attained) the ability to differentiate between entry in those types of markets, which looks toward breaking down a monopoly, and certain types of entry in our competitive industry structure, which actually could have an anti-competitive effect.

Without an explicit mandate from this Congress on this matter, we are concerned that in implementing a new legislative mandate for competition, the FCC could—through ignorance or inadvertence—destroy the one example of a competitive industry structure in domestic telecommunications carriage that antedated the passage of

the new mandate. In such case, the potential for treble damages would provide little solace for the existing RCCs whose businesses had been destroyed.

What is needed, in our view, is explicit pre-grant review of entry in the radio licensing process based on rigorous antitrust analysis. We have previously proposed language to the Subcommittee designed to accomplish this, and we again request that it be favorably considered.

Second, access to sufficient spectrum to satisfy the public demand for our services is always a problem. As a result, there is continuous conflict between established carriers who require additional spectrum to accommodate subscriber growth and new carriers who are seeking access to the same spectrum in order to get into business initially. What frequently happens is that the FCC promotes the interests of competitive entry by awarding the channel to the new entrant—thereby penalizing the existing carrier by denying it the ability to grow—or it fashions licensing policies that can be most charitably characterized as bureaucratic expediency and a business person's nightmare.

A good example of this is a recent FCC decision to open up 24 new mobile telephone channels in a few of the larger cities in the country. In one of those markets there are already 26 existing RCCs, as well as other new entrants waiting in the wings for additional spectrum to be made available. The situation in the other markets was similar, but not quite as extreme. Faced with the prospect of mutually exclusive applications and the necessity for comparative hearings, the FCC basically threw up its hands, adopted a perpetual open entry policy on the frequencies in question, and told all existing and new competitors to "cooperate" with each other to come up with plans to make the frequencies practicably useable in the environment it had created.

We respectfully submit that this is a classic example of promoting competition at the expense of fair competition in the RCC industry. To prevent this type of problem in the future, we request that the Congress make clear in the legislation that the FCC may not deny adequate spectrum to existing RCCs for the sake of promoting competitive entry into the industry. If competition is to be the rule, and we think it properly should be, the FCC must be obligated to allocate sufficient spectrum to the industry to satisfy the needs of both existing and new competitors.

Lastly, I would like to focus on the antitrust/anticompetitive problems which AT&T's presence in the common carrier mobile communications business creates. There are many examples of types of conduct which AT&T and its subsidiaries regularly engage in which restrain our industry's growth and obstruct its development. I would like to share a few of them with the Subcommittee:

In Boise, Idaho, Bell engineered its wireline telephone facilities so that calls to or from its own mobile telephone units over a wide geographic area were charged to the calling party as a local call. Many areas where this arrangement was effected normally would have required toll calls for ordinary landline telephone-to-landline telephone calls. This was a beautiful system which gave proper recognition to the wide area coverage of a base station transmitter, and meant that a subscriber located in the outer areas of reliable coverage did not have to place a toll call to reach a landline telephone which could be as close as a block away.

But when a competing RCC requested access for its own mobile system to the same block of numbers that had been specially engineered in this fashion, Bell flatly refused. After litigation was threatened, Bell's "solution" to the problem was to reduce the local calling arrangement to the normal Boise local exchange area. That is, rather than provide a competitor with the same wide area interconnection coverage, Bell was willing to spend thousands of dollars of its wireline customers' money to tear out the system it had engineered; Bell was willing to deny all mobile subscribers in the area the enhanced service arrangement; and Bell was willing to impose high service charges on some of its own mobile customers—again, purely for the sake of inhibiting a competitor.

In pricing monopoly wireline exchange facilities which RCCs must have to effect interconnection with the telephone company, the Bell companies, at AT&T's direction, are using a costing methodology which the FCC has repeatedly found to overstate actual costs substantially. These facilities (outpulsing numbers) frequently are not used by Bell for its own paging systems. Thus, by inflating its prices to the RCCs, Bell effectively puts a substantial squeeze on an RCC's cost of doing business. The competitive benefit to Bell's own paging services from this practice is obvious; but even at a reasonable price, Bell would earn far more money by supplying facilities to RCCs than it ever has from the radio services it directly provides.

In pricing its own competitive radio services to the public, Bell consistently employs its "contribution" theory of ratemaking. This theory as practiced by Bell has been repeatedly found by the FCC to constitute unlawful cross-subsidization of competitive services from monopoly service revenues. After time-consuming and

costly litigation before state commissions, RCCs in such cities as Boston, Massachusetts; Lansing, Michigan; and Los Angeles, California; have eventually proved their allegations of anticompetitive pricing and have obtained orders requiring Bell to raise its paging rates. We are morally certain that such pricing practices are pervasive, but we do not have the resources at our disposal to litigate this issue before all 50 state commissions for each city in which Bell has a paging license.

We have information indicating very clearly that Bell is financing *all* of its mammoth cellular system developmental activities directly from the pockets of its monopoly wireline subscribers. It does so by charging such costs to the operating companies as part of the so-called "license contract fee". Such fees, of course, are then expensed in the monopoly services by the operating companies as operating costs. Stated another way, its purely competitive activities in this area are being financed purely by monopoly service revenues.

Much attention is paid in the bills, to assuring that Bell is allowed to compete in any business it chooses. But we must ask, at what cost to the public in the form of cross-subsidization of its competitive service activities from its monopoly ratepayers' pockets? At what cost to the public in the form of higher costs to competitors' subscribers, who pay as part of their charges the substantial litigation expenses which a competitor must necessarily incur in order to stay in business?

As attractive and necessary as accounting procedures and fully separated entity concepts may be, we must respectfully point out that they do not solve the problem of converting Bell into a fair competitor. Cost accounting is necessarily arbitrary in the final analysis, although it is a useful tool in getting at least some kind of handle on Bell's various service costs. Fully separated entities are also useful in this connection, but can be defeated to a large extent through various forms of intercorporate transactions. Further, the fact is that because of its vast monopoly service base, Bell has an incredible staying power, and can tolerate a much lower return in a competitive service for a much longer time than can any normal competitor.

AT&T did not attain its overwhelming dominance in telecommunications purely through its own efforts to serve the public. Rather, the collective weight of the federal and state governments were used to shield it from competitive intrusions for many years while it accumulated its vast economic and financial power. Since this government assisted AT&T to attain its present position, we do not think it at all unfair or unreasonable for the same government to impose some restrictions on AT&T's conduct at the time the shield is removed. The RCC industry is particularly vulnerable to competitive abuses by AT&T in the new environment contemplated by S. 611 and S. 622; we see nothing in its actions to indicate that it would not continue in the future the same kind of anticompetitive conduct we have experienced in the past and continue to experience today.

Substantial, effective competition already exists in the RCC industry, which will continue and be enhanced as a matter of course as new spectrum bands are opened. Under these circumstances, the limited, incremental benefit to the public, if any, from allowing Bell to expand its presence in these services is far outweighed by the various direct and indirect costs to the public arising from its competitive misconduct. We respectfully submit that the only real solution to this problem is that Bell must restructure itself so that it can fairly compete in the ordinary course of events.

To provide the necessary incentives to do so, we submit that the Congress should prohibit Bell from licensing any new systems in the common carrier mobile services until such time as it loses its Category II status for all interexchange services, unless the Commission finds prior thereto that its entry is necessary for the public to be adequately served.

CONCLUSION

That completes my prepared statement. I would like to again thank the Subcommittee on Telocator's behalf for this opportunity to state our views on S. 611 and S. 622.

Senator SCHMITT [presiding]. Thank you very much.

We have a vote on. The next set of bells is going to ring momentarily.

So, Mr. Marshall, if you would allow me, I will recess the hearings at this point; and either Senator Hollings or I will be back shortly. He will probably be back first.

[Recess.]

Senator GOLDWATER [presiding]. In order to expedite matters, Mr. Marshall, you may proceed as you care.

**STATEMENT OF TRAVIS MARSHALL, VICE PRESIDENT,
MOTOROLA, INC.**

Mr. MARSHALL. Thank you, Senator Goldwater.

Mr. Chairman, members of the staff, my name is Travis Marshall, and I am vice president of Motorola, Inc. Our written testimony details Motorola's role in providing telecommunications equipment and systems to a wide variety of users, both domestic and international.

For specific purposes of the panel, I would emphasize that the wireline companies, notably A.T. & T., and the radio common carriers use Motorola mobile telephone and paging equipment and systems design extensively. Thus, our interest in the common carrier phase of S. 611 and S. 622 is substantial. While our written testimony encompasses our views of many provisions of these bills, I will confine myself to only a few highlights in this oral presentation.

Motorola supports the clear mandate in both S. 611 and S. 622 to establish marketplace forces as the cornerstone of our Nation's telecommunication policy.

Both bills seek to align Government regulations more closely with developments in the marketplace without completely rewriting the Communications Act of 1934. The approach is understandable and appears feasible. However, a clear delineation is still lacking between private and common carrier land mobile as this distinction does not exist in the original act. Unfortunately, neither S. 611 nor S. 622 correct this omission. Private land mobile systems provide internal communication among employees of a particular business or organization and comprise approximately 97 percent, or over 7 million, licensed land mobile transmitters. These private systems bear little, if any, resemblance to common carrier land mobile operations which via interconnection through the wireline network primarily provide mobile telephone or paging service to the general public.

The FCC has recognized the dissimilarity of these two land mobile communication modes and, accordingly, has imposed virtually no economic regulation over private land mobile systems. Each individual user is a licensee who has control over his own system; each purchases or leases equipment from one of dozens of highly competitive suppliers and his assigned frequencies are shared by other similarly licensed users.

This situation pertains even where more than one licensee shares common equipment and facilities. Thus, common carrier provisions, such as closed entry or tariff regulations, have proved unnecessary.

Motorola is encouraged by the steps which have been taken in these bills toward deregulation of the entire telecommunications industry, particularly the mobile radio common carrier.

The resulting competition, however, must be genuine. The issue in the land mobile area is simple: How does one free A.T. & T. from regulatory and judicial constraints so that it can compete, but at the same time invoke sufficient safeguards so that A.T. & T. will not unfairly dominate any given market?

The difficulty, at least as far as land mobile radio is concerned, is that none of the provisions in either bill address the basic problem. Can A.T. & T. be a fair competitor in land mobile?

Heretofore, A.T. & T. has been inhibited by the consent decree in the private services and by lack of spectrum in the common carrier service. The bills, if enacted, would essentially remove the key governmental constraints. Further, the FCC recently allocated 115 MHz, almost three times what had been available, for land mobile systems, thereby providing the opportunity for growth which had not existed before.

The consent decree restricted A.T. & T. in essence to tariffed common carrier services. As we understand it, S. 611, by definition, would make any service that A.T. & T. enters a regulated common carrier service. As this, in effect, releases A.T. & T. from the restraints of the consent decree, it is likely that A.T. & T. will endeavor to penetrate the private land mobile radio services.

This would cause what has previously been a highly competitive marketplace to become at least a partially regulated common carrier market. Further, if A.T. & T. were to offer lease/maintenance services to the private land mobile community, thousands of small dealers and service stations would be unable to compete.

The potential for domination also exists in the newly established specialized mobile radio systems market. These SMRS's are third-party for hire systems to serve eligible licensees in the private land mobile services. SMRS's were construed by the Commission and affirmed by the courts to be noncommon carrier. Thus, today, SMRS's could not be licensed to A.T. & T. or its subsidiaries, because they are nontariffed services.

These bills eliminate this type of preclusion and permit these entities to operate an unlimited number of such systems. In effect, another noncommon carrier service could become a regulated carrier service as a result of the provisions of S. 611.

This seems to us to be a big move in the wrong direction.

Another phase of the FCC's 115 MHz allocation involved setting aside 40 MHz for a nationwide compatible common carrier mobile radio telephone system, utilizing a cellular system configuration. This suballocation increases common carrier spectrum by 1,000 percent, or 10-fold. The lure of a 40 MHz allocation, which could be dominated by A.T. & T. because of its vast resources, could surely emasculate radio common carrier competition.

H.R. 3333 contains a prohibition regarding the ability of A.T. & T. to offer mobile radio systems and services. This provision would solve the anticompetitive problem if it also precluded lease/maintenance services. We do not believe that excluding A.T. & T. from mobile radio should inhibit its continued healthy growth.

For example, in the RCC cellular system we referenced in our written testimony, projected revenue studies indicate that after the systems are fully developed, A.T. & T. will be the largest supplier to the systems.

Competition cannot flourish if telecommunications involving the use of the radio spectrum are subject to government constraints on the State level. Clearly, it would be counterproductive to allow the States to step in and regulate the void created by a Federal policy of deregulation. Both S. 611 and S. 622 appear to vest full jurisdic-

tion over regulation of the electromagnetic spectrum with the FCC. We urge that any final version of these bills make clear either in the statutory language or accompanying legislative report that State regulation of systems utilizing radio spectrum is unequivocally preempted.

S. 611 proposes a land mobile spectrum fee process that pits private land mobile users against each other with the greatest negative impact on the small business or agricultural user. These users do not receive direct financial return from their use of the spectrum. Mobile radio is a tool they use in providing the public with goods and services.

The plumber, the farmer, the delivery man, the appliance serviceman, use radio to be more effective and more efficient in providing their services. A fee based solely on what the market will bear does not recognize that differing services to the public must continue to have access to mobile communications at an affordable cost.

S. 622 avoids a spectrum fee, but imposes a charge related to FCC costs. According to a Commission study, approximately 50 percent of total Commission costs would be borne by private land mobile licensees, and this amount is more than twice what broadcasters would pay. This does not seem fair.

In addition, this approach places no limit on future FCC costs which would be recovered from license fees. Without some basis for limiting costs, the FCC could potentially expand its regulatory and study activities at will, knowing that offsetting fee increases could be imposed.

Motorola does not object to the concept that reasonable license processing costs both direct and indirect should be borne by applicants; however, a means should be provided to limit growth of these costs, and to promote FCC efficiency.

A spectrum access fee could be acceptable under appropriate conditions. If, for example, such a fee were applied to all users in a manner that could cause unused or inefficiently used spectrum to be reallocated to growing services such as land mobile then the fee would have a meaning and purpose through improved spectrum efficiency. It is clear that spectrum efficiency has not been accomplished in major portions of the spectrum with the UHF TV band being the clearest area where improvements on efficiency are needed to future uses by all growing services. If a fee structure could accomplish this, it would, I believe, be in the public interest.

In the international area, Motorola is gratified to note the provisions of S. 622, section 226(g)(3), concerning the selection and participation of private industry delegates to international telecommunications meetings.

Since the status and timing of a new or modified Communications Act is presently indefinite, we would suggest that the provisions of section 226(g) superseding section 207 of title XVIII be the subject of separate legislation so that it can be enacted prior to the 1979 WARC.

Mr. Chairman, I want to thank you and the subcommittee for this opportunity to address you.

[The statement follows:]

STATEMENT OF TRAVIS MARSHALL, VICE PRESIDENT, MOTOROLA, INC.

Motorola, Inc. is a leading systems designer and manufacturer of land mobile radio equipment for both private users and common carriers. Our products are marketed domestically and internationally. In addition, our company manufactures CB equipment, AM-FM radios for automobiles, systems for the Federal Government, and semiconductor devices used in a broad variety of electronic and telecommunications systems. One of our subsidiaries is actively engaged in providing data processing and communications equipment. Thus, our interest in the ramifications of S. 611 and S. 622 is substantial.

Motorola supports the clear mandate in both S. 611 and S. 622 to establish marketplace forces as the cornerstone of our nation's telecommunication policy. Competition has already proved to be an effective and cost-efficient regulator in those portions of the communications industry where government intervention has been minimal, and in other sectors of the economy such as the recently deregulated airline industry. Where true competition exists and is allowed to operate without government imposed restrictions, both the public and business benefit from the resulting variety of choices in terms of superior quality of products and lower prices.

PRIVATE AND COMMON CARRIER, LAND MOBILE: ROLE OF A.T. & T.

Both these Bills seek to align government regulations more closely with the new technology and developments in telecommunications by revising the focus and language of existing legislation rather than by rewriting completely the Communications Act of 1934. The approach is understandable and, in most cases, feasible. It does, however, mean that a clear delineation is still lacking between private and common carrier land mobile as this distinction did not exist and was not envisioned when the original Act was adopted. Unfortunately, neither S. 611 nor S. 622 corrects this omission. Private land mobile systems which provide internal communication among employees of a particular business or organization now compromise approximately 97 percent (over 7 million) of licensed land mobile transmitters. These private systems bear little, if any, resemblance to common carrier land mobile operations which via interconnection through the wireline network primarily provide paging and mobile telephone service to the general public for hire (See S. 611 Sec. 103(36)). The Federal Communications Commission has recognized the dissimilarity of these two land mobile communication modes and, accordingly, has imposed virtually no regulation over private land mobile systems. Each individual user is a licensee who has control over his own system; each purchases or leases equipment from one of dozens of highly competitive suppliers, his assigned frequencies are shared by other similar licensed users. This situation pertains even where more than one licensee shares common equipment and facilities.

Thus, common carrier provisions such as closed entry or tariff regulations have proved unnecessary. While neither Bill appears to threaten a potential increase in private land mobile regulation and, in fact, S. 622 specifically mentions private land mobile (Sec. 336) it is surely time to recognize explicitly that these two services are disparate, distinguishable and should be subject to appropriately individual regulatory treatment.

Motorola is encouraged by the steps which have been taken in these Bills toward deregulation of the entire telecommunications industry and of the radio common carriers in particular (S. 611, Section 201 et seq.; S. 622 Section 201 et seq.).

Competition, however, must be genuine; to have only the appearance of competition rather than the reality would be worse than no competition at all. The issue in the common carrier area is superficially simple: How does one free A.T. & T. from regulatory and judicial constraints so that it can compete, but at the same time invoke sufficient safeguards so that A.T. & T. will not unfairly dominate any given market.

Both Bills (S. 611, Sec. 205; S. 622 Sec. 225) endeavor to strike a proper balance by prohibitions against cross-subsidization, by raising the possibility of separate companies, and even by possibly banning a monopoly carrier from a particular service. Under both Bills, the Commission has the power to monitor and/or investigate the activities of A.T. & T. and, should abuses occur, to invoke appropriate remedies.

The difficulty, at least as far as land mobile radio is concerned, is that none of these provisions addresses the basic problem: Can A.T. & T. be a fair competitor either in the common carrier or private land mobile market in light of its size and pure economic power?

Heretofore, A.T. & T. has been inhibited by certain regulatory processes, by the Consent Decree in the private service and by the fact that the spectrum available for common carrier land mobile use was so scanty that this market offered only limited growth potential. The Bills, if enacted, would essentially remove the key Governmental constraints. Further, the FCC recently allocated 115 MHz, almost

three times what had been available, for land mobile systems, thereby providing the opportunity for growth which hitherto had not existed.

Absent the Consent Decree which restricted A.T. & T. in essence to tariffed common carrier services, it is likely that A.T. & T. will endeavor to penetrate the private land mobile radio service. All the competitive equipment suppliers combined fall far short of A.T. & T.'s assets. A.T. & T. will be in a economic "cat-bird" seat, able to purchase enormous amounts of equipment to its unique specification from the lowest bidder, whether domestic or offshore. If A.T. & T. were to embark on this course, it is obvious and inevitable that few, if any competitors would survive; the antithesis of the thrust of these Bills. Further, if A.T. & T. were, in addition, to offer lease/maintenance to the private land mobile community, thousands of small dealers and service stations would be unable to compete. A.T. & T.'s capability to utilize its enormous economies of size would produce such a result, even if that company operated wholly within the permissible confines of these Bills.

One striking example of the potential for domination is in the Specialized Mobile Radio Systems (SMRS) market established in the aforementioned recent FCC allocation proceeding. These SMRS are third-party for hire systems to serve licensees eligible in the private land mobile services. SMRS were construed by the Commission and affirmed by the Courts to be non-common carrier. Thus today SMRS could not be licensed to A.T. & T. or its subsidiaries, because they are non-tariffed services. These Bills would wipe away this type of preclusion and would permit these entities to operate an unlimited number of such systems, subject in S. 611 only to the provisions of Sec. 204(e) which do not address such non-common carrier matters. In fact, A.T. & T. would have a freer reign in this market than Motorola since we are barred by FCC Rules from having more than one SMRS nation-wide.

Another phase of the FCC's 115 MHz allocation involved setting aside 40 MHz for a nation-wide compatible common carrier mobile radio telephone system, utilizing a "cellular" system configuration. This sub allocation increases common carrier spectrum by 1000 percent. Two systems are currently being developed using two different economic approaches. The Illinois Bell Telephone system places heavy reliance on ESS land-line control and switching and requires substantial "up front" investment. The other, developed for a Radio Common Carrier, recognizes the inability of this less affluent operator to make a heavy initial investment. Thus, the system is designed to match investment to subscriber growth. Even under these circumstances, it will take time for these RCCs to acquire financing, engineering, etc. The lure of a 40 MHz allocation, which could be dominated by A.T. & T. because of its vast resources would surely emasculate competition.

It should be re-emphasized that we are assuming that this domination of both the private dispatch and common carrier mobile radio markets will be accomplished within the permissible framework of these Bills, i.e. there will be no cross-subsidization; there may be separate companies, etc. The innate size of the entity will destroy competition.

Therefore, we conclude that these Bills should be amended to exclude A.T. & T. from mobile radio, including lease/maintenance. H.R. 3333 does contain a prohibition regarding the ability of A.T. & T. to offer mobile radio systems and services, and this provision (Sec. 330 (d)) would be satisfactory if it also encompassed lease/maintenance as a preclusion.

We must point out that the above recommendation is predicated on the proposed legislation under consideration. We would have opted, given the opportunity, to support legislation that would have delineated between monopoly and competitive services and then would have precluded an entity from engaging in both. We do not believe that confining A.T. & T. to monopoly services would have inhibited its continued healthy growth. For example, in the RCC cellular system we referenced earlier, projected revenue studies indicate that after the systems are fully developed, a greater portion of the total revenues will accrue as a result of providing the required land lines and interconnections into the telephone network than will the revenues related to the radio portion.

Perhaps, the economic clout of A.T. & T. will be diluted over a period of years so that its intrusion into mobile radio can be effected without destroying competition, but now is not that time.

PREEMPTION

Competition cannot flourish, if telecommunications involving use of the radio spectrum is subject to government constraints on the state level. Clearly, it would be counterproductive to allow the states to step in and regulate the void created by a federal policy of deregulation. Both S. 611 and S. 622 appear to vest full jurisdiction over regulation of the electromagnetic spectrum. (See, for example, S. 611, Sec. 102(a) ". . . all transmission of electromagnetic energy by radio".) We would then

assume that Section 102(b) which precludes FCC jurisdiction over "charges, practices . . ." etc. which are not part of an "interexchange service" is referring to such matters as local wireline exchange service. We urge that any final version of these Bills make clear either in the statutory language or accompanying legislative report that state regulation of systems utilizing radio spectrum is unequivocally preempted.

Our concern in this area is founded upon prior experience that the states are far from reluctant to impose common carrier type regulations on today's intrastate telecommunications which have already been classified as "private" by the Federal Communications Commission. Small businesses commonly use private two-way radio systems as a tool to better manage their operations; unlike radio common carriers whose income is derived directly from utilization of the radio spectrum. The Federal Communications Commission has consistently determined that these systems, operating on private land mobile frequencies, are not common carriers even if a cooperative or multiple licensing arrangement, such as a community repeater, is employed. Nevertheless, some states and/or PUCs have reached contrary decisions and have imposed common carrier restrictions on these operations. Such determinations may be and, on occasion, have been successfully challenged in legal proceedings; yet the expenses and time delays incurred place an unwarranted burden on the end user whose initial choice of a communications system was largely dictated by monetary considerations. These users, the small farmer or local delivery service, have recognized the benefits that radio communication will provide; they have made a substantial investment in a system which best meets their technical and financial requirements; they have complied with all applicable FCC regulations, only to find that the state has erected yet another barrier which, for some, is insurmountable. Neither these users nor the economic efficiency goals of competition are served by state regulations which simply impede the unhampered operation of marketplace forces.

FEEs

Another area in which Motorola is vitally interested is that of licensing fees. Here, the two Bills differ substantially. Section 101(6)(a) of S. 622 contemplates a fee schedule similar to that used by the FCC in the past. The charge imposed would be based on two factors: the costs to the Commission of processing the license and the costs directly or indirectly attributable to regulating the licensee. We feel that this schedule would comply with the judicial requirements set out in the NCTA and EIA decisions. The Federal Communications Commission would, in essence, be self-supporting, not financed by tax dollars from the general public. In addition, this section allows the Commission to waive the fee for any governmental or noncommercial users if the public interest would be served thereby. This flexible arrangement would permit such groups access to radio spectrum which, in some extreme cases, might otherwise be precluded even though the fee imposed would not be excessive. This Bill does not explicitly prohibit placing a scarcity value on the spectrum itself; however, we assume that the factors listed are intended to be exclusive.

Even under this moderate approach, we query its elementary fairness vis-a-vis private land mobile users. The FCC has calculated that under this formula, this class of users would generate almost 50 percent of the anticipated revenues; more than twice what Broadcasters would pay. Yet, as we shall develop more completely in our discussion of the S. 611 fee proposal, these users derive no direct financial benefit from the spectrum. The plumber will still fix leaky pipes; the farmer will still plant crops, irrespective of whether they use radio. For them, it is a management tool to increase productivity and efficiency. For a broadcaster or a common carrier, radio is the sine qua non; profits emanate directly from use of the spectrum. This anomaly ought to be redressed.

In addition, we must call attention to the fact that any approach predicated on Commission costs is an open invitation to the FCC to seek budget increases, secure in the knowledge that fees can be raised to match such increases. Cost efficiency may be ignored; contracts for unneeded studies can be awarded, etc., because licensees will inevitably have to pay the tab, whatever it is.

S. 611 would go substantially further; it specifically states that use of the spectrum confers benefits to licensees and that the fees established must be predicated on the fair market value of the benefit conferred, with some minor exceptions (Section 106). Motorola has previously stated its objections to this approach both before the House subcommittee last summer and in our comments to the FCC in Docket 78-316. Our position has not changed. Competition, the key concept in these instant Bills, will not be promoted by awarding spectrum to the highest bidder, particularly in the private land mobile services. First, as stated previously, these users derive no direct financial benefit from the spectrum, unlike licensees in the common carrier or broadcast services. The value of radio to a private land mobile

licensee is, we believe, not susceptible to quantification and certainly cannot be based on the elements proposed in Section 106(b). Second, assuming that a scarcity (or fair market) value could reasonably be applied to common carrier spectrum (since broadcast is specifically excluded), should a licensee or applicant in this service be unable to afford a given frequency, he will be replaced by one who will provide virtually identical service to the public. While we have doubts about the validity of such a fee even in this case, at least like will be replaced by like. This is not the case in private land mobile. These users provide a multitude of disparate services, all of which benefit the public, but in unique ways. Here, the public benefits because radios increase productivity; savings are passed on in terms of better service and lower prices. A fee schedule based on what the market will bear will inescapably insure that smaller and newer enterprises will *not* be able to vie successfully for spectrum. Affluent users, whatever business they are in, will have a distinct advantage—like will not be replaced by like. This result would be incompatible with the avowed aim of S. 611, to promote competition for the ultimate benefit of the general public.

OTHER PROVISIONS

Cross-subsidization and separate companies

Although, as we have stated previously, we do not believe that mere safeguards against cross-subsidization will be sufficient to assure the objective of fair competition, we do feel that Section 205(b) of S. 611 and Section 225(d) of S. 622 would be more effective, if strengthened.

For example, both sections are silent as to what penalties would be invoked if, in fact, cross-subsidization were found to exist. If the possibility of criminal sanctions were present, it might provide a meaningful deterrent against such action. It should be noted that the traditional remedies against this type of illegal activity are unlikely to be successful or timely. Rebates to the customers whose overpayments are used to cross-subsidize competitive activities will not help the injured competitors. Suits by the competitors to enjoin these illegal cross-subsidies and/or collect damages historically drag on for several years. Plaintiffs who ultimately are awarded compensatory judgments often find that it is too late to resume their attempts to be competitive.

As far as separate companies are concerned, the Bills take different tacks. S. 622 gives the FCC the authority to determine whether or not a separate company should be mandated but provides no guidelines as to what factors the Commission ought to consider in making such a finding. The likelihood, therefore, of lengthy administrative and judicial proceedings before such questions are answered definitively is extremely high.

S. 611 in Section 205(e) endeavors to establish guidelines, proposing that if a carrier has no more than one-third of the revenues "... received by all carriers providing similar services within the same market", it shall be deemed to be competitive, and presumably would not need to form a separate company (nor, of course, would it need to be regulated as a Category II carrier). Let us look at the anomaly that would result in the case of the Specialized Mobile Radio Systems (SMRS) described earlier. Today, the operators of these systems are non-common carriers. As we read these Bills, A.T. & T. could enter this market as a Category I carrier and compete for this private dispatch business. So, even at the first level we would have "competitive" common carriers competing with non-common carriers. If A.T. & T. captured more than one-third of the SMRS business, and if the reason for this market share were found to be because of cross-subsidization or because of some illegal activities, corrective action including the barring of that carrier from providing SMRS service could be ordered. Otherwise, A.T. & T. would become a Category II carrier and would be subject to rate regulation. Now, we would have "dominant" common carriers competing with non-common carriers. Further, the issue of market share may not be clear-cut. For example, if A.T. & T. were an operator of a cellular mobile telephone system (almost certainly a Category II carrier) in this area, it would be permitted, under FCC rules, to render some private dispatch service. Since, under our example, A.T. & T. also is in the SMRS market, is the Commission to apply the one-third guideline on the total aggregate of the private dispatch business provided, or is each "service", i.e. SMRS and Cellular, calculated separately?

These real-life enigmas reinforce our two basic contentions:

1. Monopoly and Competitive services should not be co-mingled.
2. If they are, mobile radio must be treated as an exception and must be excluded from the purview of A.T. & T.

Private land mobile

We have stressed our position that the failure to recognize these services in the fundamental regulatory scheme is apt to cause fundamental disorientations in this market and may well result in less rather than more competition. We should point out, however, that the one provision in S. 622, Section 336(a) wherein private land mobile is involved is salutary. This would enable the Commission specifically to authorize industry frequency coordination committees to make recommendations as to which frequencies are best suited for a particular applicant. This long-standing procedure has sometimes been challenged on the grounds that it is an unlawful delegation by the Commission of its statutory authority to assign frequencies. While we are sure that the role of these committees will continue to be purely advisory, it is useful to have the matter clarified as Section 336(a) does.

INTERNATIONAL TELECOMMUNICATIONS

In the international area, Motorola is gratified to note the provisions of S. 622 Section 226(g)(3) concerning the selection and participation of private industry delegates to international telecommunications meetings. We view this as a beneficial proposal which can further U.S. interests by making more effective use of private industry experts at such meetings.

This provision is particularly relevant to the International Telecommunications Union upcoming General World Administrative Radio Conference (GWARC) to be held in Geneva beginning September 24, 1979. This Conference will deal with major matters of radio spectrum allocations and international regulations for all the radio services and the results may be applicable for a span up to 20 years.

We understand the Department of State is in the process of forming the U.S. GWARC delegation which will include private industry representatives. The selection and the planned Conference role of such representatives is being made in accordance with Department of State, Final Guidelines, participation of Private Sector Representatives on U.S. Delegations (Public Notice 655). The planned conference role of such representatives is severely limited by the application of Section 202 through 209 of Title 18 of the United States Code.

The delegation selection process for private sector representatives under the Final Guidelines, however, appears to be in part compatible with the provisions of Section 226(g).

It would be highly desirable to have the subject provisions of 226(g) which would supersede Section 207 of Title 18 prior to the GWARC. Since the status and timing of a new or modified Communications Act is presently indefinite, we would suggest that Section 226(g) be the subject of separate legislation so that it can be enacted prior to the GWARC.

Senator HOLLINGS. Very good.

And all of the speeches from all of the witnesses will be included in their entirety in the record.

Mr. Perrin, I guess what we would really like to do is to get you and Mr. Weinberg. You say in your written statement that a type of conduct A.T. & T. would engage in would restrain the growth of the industry and its development. Can you elaborate on that?

Mr. PERRIN. Yes, Senator. To operate our businesses, it is necessary for us to interconnect, of course, into the Bell network. This requires that we go to the Bell companies around the country to secure facilities, numbers, lease lines, things of that sort. That, over the years, has been extremely difficult at times. At the start of the relationship, Bell for many years refused to interconnect with us at all, and it wasn't until the early 1960's that we were able to gain interconnection rights with Bell.

We have been treated by Bell and other wire line companies as a customer, as opposed to a cocarrier, in our dealing with them. If the Bell companies refuse to recognize the RCCs as cocarriers on a continuing basis, that makes it difficult for us to operate our systems.

Senator HOLLINGS. What about that, Mr. Weinberg?

Mr. WEINBERG. Obviously, I disagree with Mr. Perrin, Senator. I think that we have offered full and fair interconnection with the

radio common carriers since the early 1960s, as Mr. Perrin referred to it. I personally, along with Mr. Perrin, attended a number of meetings under the aegis of the Commission—I guess it was 3 years ago—where some of the problems that the industry had facing it were discussed at length. I believe at the conclusion of that meeting, both parties were agreeable to interconnection terms.

We have fulfilled those interconnection terms, and I think the radio common carrier industry at that time was satisfied with those terms. Certainly, the demonstration that they do compete vigorously, is that they have more than 50 percent market share in the land mobile field, this is ample demonstration of the fact that they have not been hindered to any great degree.

Mr. PERRIN. If I could just respond briefly.

Senator HOLLINGS. Surely.

Mr. PERRIN. We have continued to grow and flourish, I would say in spite—and not because—of Bell's assistance.

Also, I think it should be indicated for the record that the interconnection meetings which Mr. Weinberg was referring to, although ending in an agreement, have now been reconvened by the FCC. The problem is that certain specific aspects of the agreement, though carefully worded and clearly understood, have not always been followed in spirit by the Bell operating companies. So, we are finding it necessary now to go back, and request further clarification and specificity in further negotiations with Bell.

Senator SCHMITT. Mr. Chairman.

Senator HOLLINGS. Senator Schmitt.

Senator SCHMITT. I wonder if I could ask one set of questions. We have an unanticipated hearing of the Science, Technology, and Space Subcommittee this afternoon, and I will have to be absent for a while.

Mr. Marshall, as you know, I along with this committee, have had a great deal of interest in the World Administrative Radio Conference, and I am intrigued by the closing remark in your testimony.

What role do you see for private industry representatives on the U.S. delegation, under existing State Department guidelines?

Mr. MARSHALL. They would be hampered, and I think it would be without foundation. The private industry people would be experts in their particular fields. If they cannot speak for the United States, then you would almost have to have an interpreter to speak each time they wanted to say something.

And I think what I saw in the provisions that were in S. 622, they would be allowed to speak for the United States, assuming just like any U.S. employee, they would be speaking the U.S. position.

Senator SCHMITT. Why can't the Government delegates handle this job, particularly if advisers are there from industry?

Mr. MARSHALL. The Government people do not have all the necessary expertise. It is a hampering process when it comes to this thing of being able to speak. If the private industry man has a thought and has to relay it to someone in Government, and then he in turn does the speaking, it would hamper the U.S. in any negotiating position, I would think. And if he could speak directly, what he has to say in his area of expertise, it would put us in a

better position during the negotiation that will go on during the work.

Senator SCHMITT. Do you have reason to believe that land mobile services specifically are going to be inadequately addressed by the U.S. delegation at WARC if things continue as they are now?

Mr. MARSHALL. No; I think that the U.S. position has been spelled out. I think that the U.S. position would be better expressed if industry people are allowed to participate.

Senator SCHMITT. What if the circumstances of the conference require modification of that position? Do you think that the representatives who will be there speaking directly for the United States will be capable of analyzing the alternative and fallback positions with respect to the U.S. position?

Mr. MARSHALL. That, I do. In fact, under the present rules, they would be participating and planning the meetings.

Senator SCHMITT. But in the give-and-take of the actual Conference, what you're saying is, you don't think that those positions can be adequately addressed by the Government representatives?

Mr. MARSHALL. I think that in the give-and-take in some areas, that will be very difficult. I think there are areas where private industry people will chair committees in the Conference, and if they cannot speak for the United States, this creates a barrier for them and for the United States.

Senator SCHMITT. I gather your recommendation is, then, that if we can find the appropriate vehicle, that it would be wise to try to move expeditiously on that special provision of S. 622 so that the WARC conference will have the full range of expertise available to the United States?

Mr. MARSHALL. I do, indeed. In fact, if there was another bill that it could be attached to, or if it could be a resolution on its own. But, in any event, to be of value to the World Administrative Radio Conference, it would have to become U.S. law before the Conference, and it would be somewhat doubtful, I think, that S. 622 will become law before then.

Senator SCHMITT. Why? I am surprised at you, Mr. Marshall, I am surprised. Well, I think the committee, to a Senator, is concerned about this problem. Now, whether we can agree to attaching that particular provision to an authorization bill or some other vehicle, only time will tell. But certainly, we appreciate your recommendation, and I think that it is probably a good suggestion. Thank you.

Thank you, Mr. Chairman.

Senator HOLLINGS. Thank you very much.

Senator Goldwater.

Senator GOLDWATER. This whole subject of land mobile communications is of great interest to me. As some of you know, we have been talking about it for many years.

I would like to ask Mr. Marshall, particularly, in the VHF band, you now have available 173.2 to 173.4; that is non-Government fixed and land mobile. And Government is given 157.073 and 157.1875 MHz. There is not enough in there for land mobile, is there?

Mr. MARSHALL. In the VHF band, there is a total of approximately 24 or 25 MHz which is shared, in some cases. And that is the

figures you are reading off of there. It is a band that is completely assigned to mostly private services, and their channels are in use by everyone from the plumber to the police department, at the moment.

Senator GOLDWATER. Could any of you indicate where you are looking for additional frequencies? In UHF you have land mobile allowed on the bottom seven UHF TV channels, 470 to 512. Where are you asking for a frequency spread that will take care of the tremendous demand for land mobile communications that is not now being filled?

Mr. MARSHALL. That spread takes place in the high end of the television band, from 806 to 1047 MHz. There is 115 MHz in that area that was allocated by the FCC several years ago for land mobile. Thus far, only 71/2 MHz have been used in the largest cities. The land mobile does have room for growth in the United States.

The spectrum needs for the next probably 15 years were allowed for in docket 18262, which allocated the 116 MHz.

Senator GOLDWATER. Would Mr. Perrin and Mr. Weinberg agree with that?

Mr. PERRIN. Well, there's no doubt about it. The future spectrum needs of the radio common carriers will come out of the 800-900 MHz region.

Senator GOLDWATER. What would the FCC think of that?

Mr. ROBERTS. The Commission's intention when the allocation was made was to carry us into the 1990's for the land mobile services. And so far, if the present rate of consumption keeps up, it is going to be a close thing. But I think we are all right, at least probably for the next decade.

Senator GOLDWATER. To get some idea of what we're talking about, can any of you gentlemen give us an idea of how many mobile telephone units could be sold tomorrow?

Mr. PERRIN. Are you talking about what the demand is today in the market for mobile telephone?

Senator GOLDWATER. Yes.

Mr. PERRIN. Well, Senator, that's difficult. My own company operates in seven Southern States, and I would say that in almost every city except one—Jacksonville, Fla.—we have exhausted the frequencies, and we have waiting lists built up. But the waiting lists in reality are for a class and type of service which is unknown today. In other words, today's service is terribly congested, it is poor service. We need to be getting into that new frequency band in order to offer a higher caliber of service.

We have waiting lists, for instance, in Phoenix and Tucson. We have waiting lists of a couple of hundred people for service. But if we were to go out on the street tomorrow with high quality service at the same cost—the demand is really an unknown factor at this time.

Mr. WEINBERG. Senator, if I may add. I agree basically with Mr. Perrin, we have about 25,000 customers who are on waiting lists. And these are unique people who are willing to wait and wait and wait and wait—sometimes, in areas such as New York City—for many, many years.

I also agree with Mr. Perrin that, as new and better services come along at more economical rates, the market is going to dramatically increase. And I guess we see cellular as being somewhat of the answer because more customers can be jammed into a cellular system and still be given equivalent land line type service.

Senator GOLDWATER. I have had experience with the requests for service that can't be met. I applied here 10 or 11 years ago in Washington, and I was over 2,000 on the list, and the other 2,000 were doctors. I would say they come first.

While we were at Bell Labs the other day, they showed us this new districtized system. They used Chicago as an example, where you can go from one district to another with an automatic frequency change.

I think we are probably talking in the nature of a half a million, minimum, demand in this country for mobile telephone service. That is why I see this as such an important field.

Mr. WEINBERG. I think your figure, if I may say so, Senator, is quite conservative.

Senator GOLDWATER. I use an RCC here in Washington that is popular across the country. It costs so much a month, and I can put a call in when the line isn't busy. I have three pickups, so it is really good. But I am not unlimited in distance. I can't dial long-distance for example.

So what we're coming to is a very sophisticated system that A.T. & T. is ready to provide.

Now I come to another question. This applies to Motorola. Reading your testimony and listening to you, I think your big fear is A.T. & T.

Would you like to see A.T. & T. restricted to merely charging for the use of their lines? Or would you mind seeing them in the business of furnishing equipment that you probably make, or they make, and supplying the system for the car or the boat or the airplane, and also getting paid for the frequency?

Mr. MARSHALL. I think that A.T. & T. should be encouraged to furnish all of the land line network and backup that is necessary for mobile radio, for which they would be paid.

As I pointed out in my statement, in the system that is going to be installed in the Baltimore-Washington area, Senator, which also uses this, that is being done for a radio carrier and common carrier, the American Radio Telephone Service.

In that system, the major supplier, once the system is in, will be A.T. & T. So it is not as though they are going to be left out of this thing. They are going to get the major revenue from it, even if the common carriers furnish the system.

My comment is that I think this really gives an opportunity to have small business come in and do a job that I believe that they can do, whether it be in the cellular field or the specialized mobile radio service, or in the private field where we have, today, thousands of repair people and dealers out there.

If they were in the cellular field instead of the radio common carriers, there would be one supplier of cellular service. As I said in my first paragraph, we are a supplier, in fact a major supplier to A.T. & T. It is a little difficult to be talking about a major customer this way, I can assure you.

However, we think that if the objective of the bill is to have competition, we are likely to have competition if you have the common carriers, radio common carriers, furnishing the service.

Senator GOLDWATER. You would have competition in the manufacture of the equipment. There's no question about that. But would you suggest, any of you gentlemen, precluding the small entrepreneur such as I use from engaging in business? It does require a frequency or two to operate it. Would you make it impossible for him to operate?

Mr. MARSHALL. I think he should be able to. As a matter of fact, the small entrepreneur—I don't know who's providing your service, but it has to be a radio common carrier, and that's what we're talking about. That kind of entrepreneur can provide the service, and he could do it on a competitive basis, I believe, without rate regulation.

Senator GOLDWATER. It is a repeater-type operation. Most of them use your equipment.

Mr. MARSHALL. We hope that will remain true, regardless of what happens. But if the competition is to go on, we think it would be better accomplished with the radio common carrier, or the small entrepreneur.

Senator GOLDWATER. Now you get into the subject of fees, and this is the only area on which the chairman and I have any small disagreement.

You indicated a fee based on cost would be an open invitation to the FCC to seek budget increases. Would you comment on that?

Mr. MARSHALL. With all due respect, yes, sir, I do. I think unless it were clearly spelled out, I think that they would be justifying increased budgets by merely increasing the fees. And since we are talking about competition, they would have the biggest monopoly in town, if they were the only person or the only entity issuing licenses and could charge whatever they chose for a license, I believe then they would be able to up the license fee.

Senator GOLDWATER. Well, the fee as projected under S. 622 is about \$34.8 million, which is about half of the FCC's 1979 budget.

So you suggest that they would have an automatic opening tomorrow to come in and want more money.

Mr. MARSHALL. They could increase the fees to come up to the amount of the budget, I'm sure.

Senator HOLLINGS. I'm wondering about what our friend Mr. Perrin will say. It's like oil, you're going to put up a big fuss, and then you're going to show us the way.

You said:

To accomplish this, we believe it would be useable to tie the nonbroadcast fee into some equitable manner into the fees for UHF television broadcasting stations, much as the fees for those stations are tied to the fees for the VHF television stations.

Can you elaborate on that?

Mr. PERRIN. Well, we're talking about setting up a relative situation there. Our situation on fees is simply that—somewhat like Mr. Marshall's—we don't see setting up a situation which is totally open-ended, and we would like a situation where there is a limit on it—such as no recovery of anything above the operating costs of the entity itself. And I guess that is what the Senator has suggested in last week's hearing.

Senator HOLLINGS. I understand that.

Going even further, though, how would you model an allocation of a fee, or the assessment of a fee, on the basis somewhat like we tied together the UHF value with the VHF value? You said a similar approach could be used?

Mr. PERRIN. Well, I think a similar approach in terms of the value. You're talking about the value of the spectrum. I think it is a question of the overall value to the commercial market. And you're talking about setting up some sort of relativity. That makes good sense, and that is a discretionary area that I don't feel competent to comment on much further, except that it makes reasonable sense that relativity be established.

Senator HOLLINGS. We were trying only a minimal fee, and in one of the statements, it was likening the fees described in S. 611 and the fee authority now with the FCC. That of course has been attacked because they have no guidelines, and it was confusing with respect to, it was both a value and the operating cost, and it did not give any guidance as to how to determine the value.

Mr. Roberts, with the FCC in your experience, do you think that the view that has been suggested now, to get a minimal fee that we have said, and the broadcasters, and he's got over 38 million, I've got 68 million—I mean, 78 million, and only a couple of million dollars, from these gentlemen here is there some way to allocate the minimum fee and liken it, as we have, to the UHF and VHF as to the value of the spectrum being used?

Mr. ROBERTS. As you know, Senator, there has been a proposal somewhat along the line that I think we're talking about here advocated on the House side, where there is a relationship established, a numerical relationship, between the fees charged for land-mobile, and the fees charged for broadcasting.

I believe they stated that the figure of 1/360th of the fee for a television station would be the maximum fee for land-mobile station. So that certainly is one possibility, so that there is a lid, and that will help assuage some of the fears that these fees are just going to go through the roof.

Senator HOLLINGS. How much does the land-mobile fee come to under that computation under the House bill?

Mr. ROBERTS. I think the maximum example they used was \$60 maximum.

Senator GOLDWATER. A year?

Mr. ROBERTS. Yes.

Senator HOLLINGS. Is that reasonable? How about it, Mr. Marshall? Is that \$60 a year outrageous?

Mr. MARSHALL. No, it is not, Senator. However, I do not think that would impede the sale of land-mobile equipment. I also think it would not discourage them to use it. And I have stated, our position is that, since mobile radio is a tool of productivity, and that productivity is what this country needs, the use of it should not be discouraged.

I think that the \$60 would not discourage the use of it, because the benefits are considerably greater than that.

Senator GOLDWATER. If the Senator would yield?

Senator HOLLINGS. Certainly.

Senator GOLDWATER. This is my major problem with fees. The FCC said \$60, and we're talking about a spectrum use from around 800 to 1100. And when you divide that down into hertz, or megahertz, or gigahertz, you don't know what frequency you're going to be using.

Isn't the user or the owner going to have to pay \$60 on every channel in the frequency he uses? And isn't that going to create problems with the total cost to the man who uses the land-mobile communications?

Mr. PERRIN. I think it depends upon the number of subscribers you're spreading it over. For example, if you're talking about a frequency fee of \$60 a frequency—and even our automatic mobile telephone systems have 30 or 35 on a channel—it spreads out to be quite minimal when you really think about it.

Senator GOLDWATER. Well, we would have to take a simpler approach, wouldn't we? My bill, for example, would come to about \$9. But when you multiply the number of channels available, and what you gentlemen are suggesting we ask for, you come up with a rather astronomical fee. I figured out the channels available in just air-to-air and air-to-ground aircraft transmission on VHF. There is a possibility of some 10,000 different channels, just from 118.5 to 135.5. And if the private pilot has to pay, or the commercial pilot has to pay \$9 for every one of those little slots, he will be in bad shape.

Mr. ROBERTS. I think I see what you are alluding to, Senator. You're talking about the situation where you've got a licensee who can operate over an entire band, as opposed to most of the services I think we've been talking to up to now. RCC's, for example, are just allocated one specific channel and that is all they can operate on.

And on those services, and many others—marine, citizens band, for example, you have a whole range of frequencies that you could operate on. Obviously this sort of arrangement would not work, and some other—

Senator GOLDWATER. That's what bothers me. I don't worry so much about television and radio broadcasting. I think you can evaluate the frequency there, and you can make a small charge. But what about the literally hundreds of thousands of other channels that people use? For example, as a radio amateur, I cover anything from 3 to 30 megahertz, I will have to hock everything I've got to go on the air.

Senator HOLLINGS. No one has that in mind.

Senator GOLDWATER. Some of them do.

Senator HOLLINGS. The citizens band radio, I'm just getting educated, Mr. Roberts. I mean, they could use numerous frequencies, but there was only, what, a \$4 or a \$5 license fee?

Mr. ROBERTS. That's correct, Senator. And under your bill, citizens band is not a commercial use, so that would be exempt.

Senator HOLLINGS. But I'm trying to give an example of where they have multiple frequency uses, but they only have the one license. I'm sure we can word it to eliminate any confusion.

Senator GOLDWATER. It is a little bit fuzzy.

Senator HOLLINGS. Well, we will clear it up. Nobody had any idea of making these fees prohibitive. We're trying our very best to tackle this.

Let me ask, Mr. Roberts, we've been working with the Commission for sometime to solve a problem of backlog in mobile licensing. Could you supply us for the record the number of applications that you have received over the last several years?

Mr. ROBERTS. Yes, sir, I would be happy to. I don't have it with me. I would be happy to submit that for the record.

Senator HOLLINGS. Yes, per year. I've been trying to get a grasp on it.

[The following information was subsequently received for the record:]

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., May 7, 1979.

Hon. ERNEST F. HOLLINGS,
Chairman, Subcommittee on Communications, Senate Committee on Commerce, Science, and Transportation, Russell Senate Office Building, Washington, D.C.

DEAR SENATOR HOLLINGS: During the hearing on S. 611 and S. 622 on the afternoon of May 1, 1979, I was asked by Senator Goldwater and you to provide the number of applications received for various categories of licenses in the Private Radio Bureau over the last several years. I am pleased to provide this information in the attachment.

Thank you for the opportunity to present my views to your committee.

Sincerely,

CARLOS V. ROBERTS,
Chief, Private Radio Bureau.

Enclosure.

**F. C. C.
PRIVATE RADIO BUREAU APPLICATION RECEIPTS**

RADIO SERVICE	FY 75	FY 76	Transitional Quarter (Jul - Sep 76)	FY 77	FY 78	FY 79 Projected for Year	FY 79 Actual Oct - Mar
Public Safety	32,313	37,907	11,577	39,968	42,490	46,750	16,869
Land Transportation	7,215	7,293	1,680	7,343	7,859	8,700	3,536
Business	65,991	71,011	19,418	91,809	117,224	129,000	62,897
Other Industrial	31,921	32,915	8,887	34,596	39,914	43,900	19,714
SUB-TOTAL, ALL LAND MOBILE	137,440	149,126	41,562	173,716	207,487	228,350	103,016
Aviation	35,350	38,184	11,208	42,711	42,919	41,130	20,463
Marine	74,580	85,877	29,065	97,437	94,536	100,300	35,958
Private Microwave	4,776	4,647	1,136	7,005	4,081	4,367	1,694
Amateur	101,373	149,130	53,710	269,037	262,859	215,270	111,944
Restricted Permits	164,178	167,535	48,562	191,110	197,402	282,000	102,313
SUB-TOTAL, ALL ABOVE SERVICES	517,697	594,499	185,243	781,016	809,284	871,417	375,388
Personal*	1,204,413	4,823,449	1,209,026	5,508,890	2,872,301	1,496,313	735,727
GRAND TOTAL, ALL SERVICES	1,722,110	5,417,948	1,394,269	6,289,906	3,681,585	2,367,730	1,111,115

* The decrease in Citizens Band receipts resulted in 16 positions being deleted from Personal Radio Service application processing during FY 78 and 79.

U. S. C. 2.
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Senator GOLDWATER. I think while we're asking for that, the FCC could also indicate their understanding of licensing by supplying us with the fees for the different parts of the entire frequency spectrum allocation for all uses. I think it would be helpful, and we could start from there.

Senator HOLLINGS. Why don't you and I write Chairman Ferris and ask him for that.

I'm sure he would be cooperative.

The problem of land-mobile licensing facing the Commission, isn't that a problem of a drastic increase in demand over the last couple of years or so? Is that the problem?

Mr. ROBERTS. That's the essence of it, Senator. Also, some hiring freezes that the President imposed, but it is mostly due to the higher number of applications.

Senator HOLLINGS. Do you know whether or not the Commission has looked into the possibility of changing the licensing process so that you could expedite the issuance?

Mr. ROBERTS. Yes, sir. In the past couple of months, we have taken several drastic measures. And I'm happy to be able to report today that, whereas a couple of months ago our licensing processing time was on the order of almost 100 days for the business radio service, which is our largest service, it is now down to between 50 and 60 days. So we have really made significant progress, and the progress is continuing, and we expect to see it declining even further.

Senator HOLLINGS. Do you think that a spectrum fee is workable, given the wide range of services competing for the nonbroadcast portion of the spectrum?

That is what Senator Goldwater was getting at.

Mr. ROBERTS. Yes, sir. I think we have got to look at the problem of people who can have access to more than one channel, what we call the band users versus the single frequency users. It is a problem that has to be dealt with, that has to be faced head-on. But other than that, I feel confident that something can be worked out.

Senator HOLLINGS. Do you think guidelines under S. 611 are sufficient? Or would you prefer something like what you use in the UHF-channel approach that was mentioned earlier?

Mr. ROBERTS. I think what is in the bill now is sufficient. I am comfortable with it, speaking personally.

Senator HOLLINGS. In your statement you supported competition in the provision of mobile telephone service, and then you went on to endorse a decision by the Commission in which they defined particular technology. Doesn't one seller of the system use the equivalent of 666 radio common carrier channels?

Mr. WEINBERG. I think you are addressing that to me, Senator?

Senator HOLLINGS. Excuse me, Mr. Weinberg. Please.

Mr. WEINBERG. Yes, there is competition in the application with the FCC for a particular locality or market. The cellular approach uses, as Senator Goldwater referred to, a large band of spectrum, so that you get the ability to utilize frequencies over and over again in the same area.

If I may just take a moment, today when you broadcast on a frequency for land-mobile, you stick up an antenna and you throw it out as far as you can throw it out.

With the cellular approach, you divide an area into cells and you put smaller antennas with much lower power in those antennas, and you put the radio frequency out over a much shorter area, so that you can reuse that same frequency over and over again in the same general locality.

Today, for example, if you have a common carrier servicing New York, you can't reuse that frequency until you get below Philadelphia. In the cellular approach, you can use the frequency over and over again in the New York area.

So as we visualize cellular approaches the metropolitan areas could get hundreds of thousands of users. Now to do that, you need a large band of spectrum, and the FCC in docket 18262 found that in order to provide this service, they would grant one applicant per market area. That developmental trial, as I mentioned, for the Bell System is being tried out in Chicago now, and for non-Bell System for radio common carriers there is a developmental trial in the Baltimore-Washington area.

I visualize that the radio common carriers will be very active in this field. I visualize that they will have additional areas that they will be interested in from a cellular viewpoint. And I look forward to a time when we all can supply many, many more users for a mobile service.

Senator HOLLINGS. What do you think of that, Mr. Perrin?

Mr. PERRIN. The opportunity is on paper for the radio common carriers, of course, to participate in the cellular area; but in reality it probably isn't as grand an opportunity as it might appear.

First of all, the overall viability of the cellular system economically has yet to be proven in both Chicago and in Washington. I think the further question that confronts many of us in the industry is that the cost of the cellular system, at least from first inspection by many of us, appears to be prohibitive in the nonmajor market areas of the country, for example, in Phoenix, Atlanta, and San Diego. The question that we're really confronted with today is: How do we as an industry put in a system that is going to be economically viable? We don't have a cross-subsidy capability that the Bell System would have.

And so while there is, on paper, an opportunity there for us to get into a business, it is at this point totally illusory and we are finding it very difficult to see the cost-effectiveness at which we're ever going to be able to implement a cellular system, other than perhaps the most major market areas of the country.

Senator HOLLINGS. You're still being treated as a customer, rather than a carrier?

Mr. PERRIN. Well, that's true in all instances. And in the case of the cellular system, Mr. Weinberg probably should have pointed out that the original Bell proposal was specifically tied into a piece of Bell equipment—the No. 1 ESS switching machine. Motorola is trying to develop a similar type device for use in the Washington-Baltimore area.

But again, going outside and buying that kind of equipment to put into a market, a nonmajor market, at this point, as I say, appears to be highly speculative and not the kind of investment certainly that we RCC's are able to make.

Mr. WEINBERG. May I respond to that?

Senator HOLLINGS. Surely.

Mr. WEINBERG. I don't consider this a paper proposal for the radio common carriers. I think the fact that one of the members of TNA is very active in this field—and in fact I understand, in a letter from the TNA after they visited Chicago, they were all very interested in this. And I thought that they were looking upon it rather enthusiastically.

As far as cross-subsidization is concerned, the FCC in its order in docket 18262 asked us to keep a complete set of figures, which we have been doing, and to assure them that all of those costs were included in the price that we charged customers. And I can assure you that it will be done. There will be no opportunity for any cross-subsidization.

I agree with Mr. Perrin that in smaller cities there will be other systems that do arise, and I think the major congestion that he and I have pointed out right today is in the major metropolitan areas, and this is a key breakthrough for those areas.

And I certainly agree that there will be less expensive and more economical systems that will be compatible, so that when you move from New York and go across the country to a small city, or when you are in a small city and drive into New York, you will be able to use the same telephone in your car, or carry it with you. So it will be a compatible unit.

Mr. PERRIN. The Bell System made a proposal which, like most Bell proposals—again in my opinion—was an overengineered piece of engineering, and what they ended up with was a system that only somebody from the Bell System and the Bell Wireline Companies could afford to put in.

They have a situation at present in which the threshold cost of getting into the system would have to be on a subsidized basis. And companies such as ours can see no way to afford to put in a system, either with Motorola or some other vendor's assistance, in a market like a Phoenix, Tucson, San Diego, or Atlanta. Those are all cities in which we operate and have waiting lists for service: The cost viability of a cellular system is simply not there on an incremental threshold basis.

And that is where I think the Congress should certainly be concerned about how service is ever going to get to the public in the smaller areas, which is really never going to happen on a cost-effective basis initially, if you follow the scheme that has been set up and the program the Bell System is proposing.

Mr. WEINBERG. I would totally disagree. I think it will be viable in the major metropolitan areas, and it will be viable in the smaller areas, as the system is developed.

Senator HOLLINGS. One more time before we close.

I was just going to ask: You would by law prohibit, Mr. Perrin, the A.T. & T. from going into the land-mobile systems? Is that right?

Mr. PERRIN. I'm sorry, Senator?

Senator HOLLINGS. You would, by law, prohibit A.T. & T. from going into the land-mobile radio business?

Mr. PERRIN. I think either one of two things has to happen.

Either, No. 1, you've got to look at a situation in which, taking it down to the final core, Bell would have to divest itself of that operation in order to be a proper competitor—and I mean fully.

Senator HOLLINGS. Well, under S. 611, as a wholly owned subsidiary, do you think it could be done that way?

Mr. PERRIN. No, I don't think it can ever be done, because I don't think anybody could ever sort out the costs of the Bell System—even the Bell System, at times.

Senator HOLLINGS. Well, I mean a new endeavor to go into that particular business. They would have to set up that company, and you could see what costs went into it, the ordinary overhead and costs.

Mr. PERRIN. The question is the cross-use of certain services. For example, I mentioned they used this No. 1 ESS switching machine as part of the cellular program. How do they cost that out? If you did it on anything other than a separate basis, in my opinion, you are never going to get at the true cost of operating one of those systems. It is virtually impossible.

Senator HOLLINGS. Senator Goldwater?

Senator GOLDWATER. I have just one question of Mr. Weinberg.

You advocated expansion of the automatic licensing provision in S. 622 to include common carrier assignments.

Now Mr. Perrin argues that expansion of that provision to common carrier land-mobile would not be prudent. Could you comment on that?

Mr. WEINBERG. My only feeling is that any time you can put a cap on regulatory delay, it is advisable to do that, Senator. And it would appear to me that the 60-day—either grant that the FCC would have an opportunity, if it found later that it was not in the public interest, to even remove the grant at a later time. And it is my personal view that when you can cap any possible time frame of a grant of a license, it is very admirable to take that position.

Senator GOLDWATER. Then you support the idea that unless the Commission acts on such application within 60 days of receipt, the license shall automatically issue?

Mr. WEINBERG. Yes, sir.

Senator GOLDWATER. Would any of you like to comment on that?

Mr. PERRIN. Just to say that certainly in terms of the licensing process as we know it today, that would appear to be an unrealistic goal in terms of getting an actual, adequate inspection of what is being proposed. For instance, our processing time for an application that we might present today on a clean application is somewhere in the 6- to 9-month range. But that is a long time, especially if the public is waiting for the service. If you arbitrarily create a situation in which you put people in business with a temporary license, and then at some later time pull that away, it doesn't seem to give the kind of comfort that is essential to operate a reasonable business enterprise and provide service on a continuing basis to the public.

Senator GOLDWATER. Well, Mr. Roberts can answer this. This has been an increasingly difficult problem for the FCC. It got so bad in citizens band, that they just gave up. And in amateur applications, it was nothing to wait 6 to 8 months to have a simple application for a license approved, and occasionally disapproved.

Mr. Roberts, is there anything that we could include in this legislation that would make the receipt of a license, or nonreceipt a little faster?

I remember, for example, I applied for a license to operate a radio on my boat. No fee. No requirements. Nothing. And it took 8 months.

Mr. ROBERTS. Well, I'm a little surprised to hear that, Senator. But on the other hand, boating licenses are seasonal and it seems that everybody forgets to apply for them until about June, and then everybody suddenly remembers and we have a sudden crunch. And this is the thing that bothers me a little bit about that 60-day provision in S. 622.

And that is, if we are going to meet the 60-day limit, we have got to staff up to have enough people to be able to issue a license in 60 days at any given time of the year, because we have no way of predicting when the license applications will come in.

As it is now, what we do is get an adequate amount of staff so that we can average a certain figure. It might be 60 days, and we may be 70, 80, or 90 days at one time, and we might be down to 30 or 40 days when it is the slack season. But we get by with less employees, and less work force, and less cost to the taxpayers that way. That is my only concern with the 60-day thing.

Senator GOLDWATER. Well, we might get you a better computer.

Mr. ROBERTS. We're working on that, too.

[The following information was subsequently received for the record:]

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., May 29, 1979.

HON. BARRY GOLDWATER,

Subcommittee on Communications, Senate Committee on Commerce, Science, and Transportation, Russell Senate Office Building, Washington, D.C.

DEAR SENATOR GOLDWATER: Thank you for your letter of May 18, 1979, in which you expressed appreciation for my appearance before the Senate Communications Subcommittee.

Your letter also asked for the processing time for licenses in land mobile services for each service and in each band. I have included this information on processing time for all radio services of the Private Radio Bureau in the attachment to this letter. I am unable to further break this information down into each band. As you probably know, a ship station or aircraft station license permits the licensee to operate in various bands authorized in the FCC Rules and Regulations for ship and aircraft stations. At one time we did require more information on our application forms and we were more specific on our licenses, but some of this has been eliminated in order to shorten our processing time.

I hope this answer is satisfactory. I sent a letter to Senator Hollings on May 7, 1979, concerning the number of license applications received which you had requested at the hearing on May 1, 1979.

I was pleased to appear before the Senate Subcommittee on Communications.

Sincerely,

CARLOS V. ROBERTS,
Chief, Private Radio Bureau.

Attachment.

Question. What is the processing time for licenses in land mobile services from the date of receipt of a license application to the date Commission approval is sent to the application? Please provide this information for each service and each band.

Answer. Following are the speed of service figure for all licenses granted by the Private Radio Bureau of the F.C.C.

	<i>Days</i>
Aircraft group.....	30
Civil air patrol.....	10
Other aviation.....	28
Ship group.....	22

	<i>Days</i>
Other marine	35
Public safety.....	99
Industrial	70
Business	59
Land transportation	101
Private operation fixed	120
General mobile	51
Radio control.....	30
CB.....	30
Amateur.....	20
R.A.C.E.S.	7

We are unable to further break this information into bands.

Senator GOLDWATER. Mr. Chairman, that's all I have.

Senator HOLLINGS. We appreciate it, and each of you have been very helpful this afternoon.

The committee will be in recess until 10 o'clock tomorrow, and we will reconvene right here in 235.

[Whereupon, at 3:30 p.m., the committee was adjourned, to reconvene at 10 a.m., Wednesday, May 2, 1979.]

AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

WEDNESDAY, MAY 2, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 10 a.m. in room 235 of the Russell Senate Office Building, Hon. Ernest F. Hollings (chairman of the subcommittee) presiding.

Senator HOLLINGS. Will the panel please come forward. Mr. Ed Goldstein, Gus Grant, Victor Schnee, and J. Robert Harcharik. Are you ready, Mr. Goldstein? We will be glad to hear from you.

STATEMENTS OF EDWARD GOLDSTEIN, AMERICAN TELEPHONE & TELEGRAPH CO., WASHINGTON, D.C.; C. GUS GRANT, SOUTHERN PACIFIC COMMUNICATIONS CO., WASHINGTON, D.C.; VICTOR SCHNEE, PROBE RESEARCH, INC., NEW YORK, N.Y.; AND J. ROBERT HARCHARIK, TYMNET, INC., CUPERTINO, CALIF.

Mr. GOLDSTEIN. Mr. Chairman, Senator Goldwater, I am Ed Goldstein, assistant financial officer of the American Telephone & Telegraph Co.

We have filed a written statement. As you know, Mr. Chairman, I will also be appearing on this afternoon's panel, where I will be giving more detailed testimony, so I will just take a few minutes on the subject of accounting.

I might say that the revision of the system which has been the subject of considerable comment is part of my responsibility. Anyone listening to what people have been saying, questions and so on, might have come to the rather surprising conclusion that the Bell System does not have an accounting system.

They might wonder how we stayed in business for 100 years without an accounting system. Of course, the fact is that we do have an accounting system, and it's a very good financial accounting system.

What we don't have is the kind of cost accounting system that allows us to get detailed data about individual services. When I left Bell Labs about 13 years ago and went to A.T. & T., I must admit I was puzzled by all the esoteric that surrounded costs. I walked up to one of our experts and said: "Can you tell me what something really cost? What is all this FDC, and so on?"

He told me a story. With your permission, I would like to more or less tell you what he said to me. It's a very simple example, but I don't think you ought to let the simplicity of the example mislead

you. It demonstrates almost all the problems one runs into in cost accounting.

The way he put it was: Suppose you're working on your boat. Suppose you work on the boat on Saturday and run out of 1-inch stainless steel screws. You get in your car and drive down to the hardware store and buy a box of stainless steel screws and pay \$2.98 for it and come back.

Now I will ask you what did that box of screws cost you?

Of course, \$2.98 is what you paid for the screws, but how about the cost of gas for the car, the tire wear, and so on?

Fine. I think I will include that. The first problem is: How many miles did you drive? How many miles per gallon do you get? How much did you pay for the tires? How long does a set of tires last?

You need most of these numbers. How about the insurance on your car? I say, wait a minute, I wouldn't charge the insurance for my car to this box of screws, because that would have occurred whether I bought this box of screws or not.

Before I know it, I am right into the fully allocated versus long run incremental cost controversy.

Now to complicate this a bit, suppose, when you decided to go downtown to get the box of screws, your wife said "Pick me up a loaf of bread at the grocery store next door to the hardware store." You did that. You bought the bread for 50 cents.

Then how much did the loaf of bread cost you? Again you paid 50 cents for it, but how about the car? Wait a minute, I was going to go downtown anyway, so the car didn't cost me anything for the loaf of bread.

You get into that argument now. Suppose you decide now you will go into fully distributed cost. On what basis should you allocate the cost of gas and the tires, and so on, to the bread and the screws? The ratio of \$2.98 to 50 cents, which would be the cost? Ratio of weight? Volume? There are all kinds of questions you have to answer before you can really meaningfully decide what the loaf of bread cost you, and what the box of screws cost you. I could go on with this example, but I think I will quit. I want to draw some conclusions from that, that are useful to our deliberations here.

Senator HOLLINGS. That is the point. No one is in competition to go down and get the box of screws for \$2.98. If you had delivery boy A who would do it for a certain price and delivery boy B, they would be estimating the gas and insurance and everything else. If I went down to get a box of screws to fix the boat, I wouldn't be thinking competitively. Perhaps that is the reason they don't have an accounting system; is that what you are saying?

Mr. GOLDSTEIN. The reason we don't have an accounting system—you are getting fairly close, I think.

The reason we don't have a cost accounting system is that we really never needed one.

Senator HOLLINGS. We have been trying to get one, but what we have to try to do is give each of the members of the panel a 10 minute opening statement and then come back if you haven't had a chance to cover all your points. We get a better exchange that way. The yellow light is for 1 minute.

Let's start your 10 minutes right now.

We don't want to take away any time from getting the screws.

Mr. GOLDSTEIN. I am almost finished.

Senator GOLDWATER. You could do it if you wanted to.

Mr. GOLDSTEIN. I am not suggesting you can't. That is the point I want to make. It isn't that you can't do it.

Senator GOLDWATER. Sounds like you are trying to wiggle out of it.

Mr. GOLDSTEIN. No, sir. Then I didn't do it right, if that is what it sounds like.

You have two things, the numbers, and you have to know what the methods are. That is the only point I want to make. Not that it's impossible.

Senator HOLLINGS. If I made you president and chairman of the board of A.T. & T., you have the same inquiring mind I have. You came from Bell and wanted to know the costs. Being the chairman of the board, don't you want to say:

I don't care whether they want it or not, but I want it. I want to know where I am headed and what I am doing. I don't know how you can tell unless you do a cost operation.

Mr. GOLDSTEIN. Before competition really arrived, we had a large number of internal indices and measurements to give us information about efficiency and productivity. But we never needed to know precisely what the cost of each service was. We knew very well what it cost us in total and what each department charged. It was really only with the advent of competition we needed to get to individual services.

In 1973 we started the system.

Senator HOLLINGS. Very good.

Let's start now with your presentation.

Mr. GOLDSTEIN. I am almost finished.

Senator HOLLINGS. Is that your statement?

Mr. GOLDSTEIN. Almost.

Senator HOLLINGS. We will include your statement in its entirety in the record.

Mr. GOLDSTEIN. All right, sir.

[The statement follows:]

STATEMENT OF EDWARD GOLDSTEIN

My name is Edward Goldstein. I am Assistant Financial Officer in the Executive Department of AT&T.

I started my Bell System career in 1949 upon graduation from the University of Minnesota with the degree of Bachelor of Electrical Engineering. After seventeen years at Bell Laboratories in various design and systems engineering assignments, I joined the Engineering Department of AT&T as Engineering Director, Equipment and Buildings. In 1970, I became Vice President—Marketing for the New York Telephone. In December 1972, I rejoined AT&T as a member of the Corporate Planning organization. In September 1973, I became Director of Product Management in the newly formed Marketing Department of AT&T. I have held my present position since August, 1978. My duties include responsibility for the revision of the Uniform System of Accounts.

I am a Fellow of the Institute of Electrical and Electronic Engineers, and Chairman of the Scientific Advisory Group of the Defense Communications Agency.

There have been a number of questions and statements during these hearings about the need for new accounting systems, their uses, how long it would or should take us to implement them, and so on. I would like to address these important questions.

But before I get started on the subject of accounting I would like to make a point. There has been much talk about the pros and cons of subsidiaries, and whether accounting could, under certain circumstances, be an adequate substitute for the

establishment of subsidiaries. Indeed, I shall be addressing that very point later on in my presentation.

But let me put this matter in perspective. AT&T does not object to the setting up of subsidiaries, *per se*. Indeed, we have subsidiaries and we could not manage the business without them. Creating another subsidiary, or even several additional subsidiaries, would not destroy the Bell System.

What we want to be sure of, however, is that our subsidiaries make business sense and make management sense. This means several things: (1) there should be no unnecessary subsidiaries; (2) each subsidiary must be economically viable; and (3) It must be possible for the subsidiaries to work with their parent and other affiliates on a reasonable basis.

What I'm suggesting, Mr. Chairman, is that you give the management of our business some flexibility in how it will carry out the mandates of the legislation. When the dust finally settles we will still have to serve our customers and to raise capital. I'm sure that neither you nor any other member of this Committee, or its staff, intend otherwise. We are concerned, however, about some of the language in the proposed bill that might well be interpreted by some future Commission, or court, in ways that would handicap us in ways not intended by the Committee. With your permission, Mr. Chairman, we will submit to the Staff some suggested wording changes that would clarify this issue.

Now, if I may, let me talk about accounting.

Anyone listening to these proceedings, or reading their transcripts, might well reach the astounding conclusion that—somehow—the Bell System had reached its present respectable size, over a period of more than a hundred years, without any accounting system at all. Having reached that conclusion, he might justifiably wonder how, during all this time, we had managed to satisfy our stockholders, the Securities and Exchange Commission, the Internal Revenue Service, and the fifty or so commissions that regulate us.

Well, of course, the fact is that we do have an accounting system that has done, and is doing, a very fine job with respect to the kind of financial reporting required by all these agencies. It keeps an accurate set of corporate books for AT&T and all of its affiliates. It produces accurate and timely balance sheets and income statements. It provides a reliable basis for corporate rate of return computations. In short, it does everything that is expected of a good financial accounting system.

So, what's the problem?

What we do not have is a good cost accounting system—as opposed to a financial accounting system—that will allow us to determine accurately and routinely, on an ongoing basis, the cost of the individual services we provide our customers.

Why doesn't our accounting system do that job?

Very simply, because it was never designed to do it. We, as well as all other telephone companies, keep our books in accordance with a set of rules known as the Uniform System of Accounts. We do this because we are required to do it by the Communications Act of 1934. Not only does that Act require us to keep our books that way, but it expressly prohibits us from keeping any other sets of books, except by the FCC's permission.

The Uniform System of Accounts, also known as the USOA, was promulgated, in essentially its present form, by the FCC in 1934. Actually, it was based on a system first prescribed by the Interstate Commerce Commission in 1913.

Well, think back to 1934—if you can. Telephone companies then offered essentially two services—local and long distance. All telephone company services were then unquestionably regulated monopolies. Some may still argue whether those may have been “the good old days,” but from an accountant's point of view there's no doubt about it—they were the good old days. Certainly, they were less complicated. Regulators and telephone companies were basically interested only in overall financial performance: the rate base, total revenues and expenses classified into a few broad categories, total rate of return, earnings per share, and so on. Management obtained information about productivity and operational performance through an elaborate system of non-financial indices and measurements.

Costs by service were of decidedly minor interest. To be sure, some detailed numbers were required to separate plant and expenses between state and interstate; and approximate—but sufficiently accurate—methods were developed for that purpose. But there were no competitors intervening in rate determinations—because there were no competitors. Even as more services were added, approximate cost determinations—through special studies—were entirely adequate: rates were determined more by value of service than by costs.

All this changed with the advent of competition. Well, not really all. There was sudden interest in the cost of individual services, but the USOA was not changed. We did more and more special cost studies as commissions, State and Federal alike,

asked for more studies, more detailed studies, more accurate studies—often under pressure of the new competitors who increasingly intervened in telephone company rate cases.

Indeed, a number of tariffs have been rejected over the years because the cost studies we submitted in their support were considered unsatisfactory. Among them were tariffs covering such services as Digital Data Service and Wide Area Telephone Service.

The USOA wasn't much help for preparing these studies, but since it served its other purposes—financial reporting and jurisdictional separations—it remained the official set of books.

Well, as I said, cost studies became a favorite target of intervenors and commission staffs.

There were really two major areas of attack. First, it was charged that the numbers were, for one reason or another, inaccurate. And second, it was charged that—regardless of the accuracy or inaccuracy of the numbers themselves—the method of using the numbers to arrive at costs was incorrect. I would say that it was this area of methodology that caused most of the controversy—rather than the numbers themselves.

Let me digress here for a minute or two to give you a simple, homely example that demonstrates the kind of problems we ran into.

Let's say you're home on a Saturday, working on your boat, and you run out of 1" stainless steel screws. You get in your car, drive 3.7 miles to the nearest hardware store, and buy a box of screws for \$2.98.

What did that box of screws "really" cost you?

Well, you paid \$2.98 for it—and that's a start. How about the gas for the trip to the store? OK, include that. How much gas? Did you measure it? No, but you can estimate it from the average mileage of your car, and the fact that you drove 2×3.7 or 7.4 miles. How much per gallon of gas? OK—82.9 cents. How about oil and tire wear? OK, let's estimate that, too—or ignore it.

Well, how about insurance, depreciation, registration, and so on? Now you have a decision to make; after all, those costs would have been incurred even if you hadn't made this particular trip. To include them, or not? You may not have realized it, but at this point you're right in the middle of the fully distributed vs. incremental cost issue.

Let's introduce one more factor. Suppose you had decided, since you were going downtown anyway, to buy a loaf of bread. It cost 50 cents. Wait a minute—you paid 50 cents, but what did it cost?

How about prorating the cost of car usage over the loaf of bread and the box of screws? After you work your way through the long run incremental ("well, you were going for the screws anyway, so the bread shouldn't carry any car cost") vs. the fully distributed cost argument, and have decided on FDC—you're in a brand new set of problems: on what basis should you allocate? Weight—by a ratio of 6 (oz. of screws): 16 (oz. of bread)? Price—\$2.98: \$0.50? Volume? Something else?

One more, final complication. Suppose that, because you spent 2 hours getting bread and screws, you didn't have time to mow your lawn and had to pay your son \$5 to do that. That too is a cost that should really be charged to the bread and screws; economists call it an "opportunity cost." I won't even try to figure out how to allocate it.

Well, what did these screws "really" cost?

All depends on why you want to know, doesn't it?

Now, don't be deceived by the simplicity of this example. It is a very representative analogy—in microcosm—of most of the problems that have beset us in the regulatory arena with respect to costs.

What can we learn from this example about accounting systems?

First, that there's no such thing as a "real" cost, uniquely determined.

Second, that both the theoretical and practical difficulties increase considerably when you try to split or allocate the cost of a single resource among more than one beneficiary of that resource.

Third, that you need to make two kinds of determinations in arriving at costs:

(1) What are the *precise numbers*—miles driven, cost of tires, price of gas, etc.? Mechanized systems can do this job in a fairly straight-forward manner, even though they may need to be huge and complex.

(2) What *method* is to be used to derive costs of an individual service or product from these numbers? This is an area of controversy that must be resolved in the context of policy and economic theory.

Let me now return to the history of our accounting system.

I had taken you to the point where competition had arrived and the need for a cost accounting system was becoming apparent—a system that would be able to sort

out in some way the costs of individual services, and not just overall financial results. At about that time we were also becoming aware of our *own internal needs* for such a system—not just to satisfy regulators and competitors, but also to run a business that was becoming increasingly complex to manage.

So, in 1973 the Bell System undertook to develop such a system—and we called it Functional Accounting. This system, based on the most modern data processing capabilities, would give us, routinely and on an ongoing basis, the cost and revenue data our managers would need to run the business, and also to satisfy the regulatory needs of this new multi-service, competitive new environment.

Functional Accounting has turned out to be a pretty big job. So far, we have spent something like \$400 million on it—and we're about half-finished.

Of course, only a relatively small portion of that money went for software development, *per se*. Most of it is going toward updating and standardizing the many data processing systems that are now operating on a day-by-day basis in the Bell System—systems that prepare employees' payrolls, compute and print out customers' bills, process and pay our suppliers' invoices and so on. With our almost one million employees, 68 million customers, and 135 million telephones. These systems process literally billions of transactions each month.

You can imagine that these are huge, complex systems that are expensive and time consuming to convert and update. Moreover, we have to maintain records for the hundred billion dollars worth of plant investment—not to mention the additional ten to fifteen billion dollars worth of plant we have been *adding* to this investment each year.

Where, then, do we stand on implementing Functional Accounting?

Well, we have completed the development of what we call Stages I and II of Functional Accounting—insofar as one ever completes huge data processing systems, which tend to grow and change as time goes on. We will have introduced Stage I and II into all of our telephone companies by the end of next year, although not into every area in every company.

Functional Accounting Stages I and II really do two things. First, they introduce the procedures and codes which are the foundation of the entire system, not just Stages I and II. Second, they provide us with pretty good accounting data to determine revenues and costs for the terminal equipment part of our business.

By the end of next year or a little later, we will have a cost accounting system that will not be perfect by any means, but that will give us the means to keep track of most of the transactions relating to terminal equipment.

That's a pretty big step forward, since—as you know—the area of terminal equipment costs has been a fairly controversial one. Controversial not so much with respect to methodology, but rather with respect to the accuracy of the numbers. Compared to network services, the theory and methodology related to costing terminal equipment are relatively straightforward. The hardware used to provide terminal equipment service to any given customer is fairly easy to identify: it's a telephone, or a data set, or a PBX. Furthermore, except for test equipment and such, each piece of equipment serves a single customer—this means that there is not much of an allocation problem.

Therefore, the accounting problem with respect to terminal equipment is well on its way to a solution.

On the other hand, accounting for network services is a much more difficult problem. The nationwide facilities network serves many different services. These include, among others, public and private switched network services, analog and digital services, TV channels and telegraph channels. Depending on how you count them, you can identify anywhere from about 16 to hundreds of services. The problem, then, is how to allocate the costs of the highly integrated network to these services. And, of course, before you can allocate these costs you have to know in great detail what they are.

And that is the job for FA III—Functional Accounting Stage III.

Before I can tell you about where that stands, we have to go back to the Uniform System of Accounts which, when we left it was doing a good job of *financial* accounting but was of little help to us in the *cost of service* accounting job.

The FCC has, of course, been quite aware of the fact that the USOA was not doing the cost accounting job. So had everyone else. It was sort of like the weather: everyone talked about it, but nobody *did* anything.

But last July, the FCC issued a Notice of Proposed Rulemaking which described, in considerable detail, a radical revision of the USOA, and asked for comments from interested parties. What the Notice proposed was no less than a complete, multipurpose accounting system that would serve both *financial* and *cost* accounting purposes; would be used by regulators, management, investors and the financial com-

munity; and would be completely auditable and verifiable. It was really more than an accounting system; indeed, it has been called a regulatory information system.

We, along with about forty other parties, responded by January 15 of this year. There followed a round of reply comments which were filed by March 15—less than two months ago. And that's where the proceeding now stands, with everyone waiting for the FCC to drop the next shoe.

In our response of more than 300 pages we told the FCC that we were in complete accord with their objectives. We did, however, point out some practical and fundamental problems we saw with their approach. We suggested a somewhat different approach which, we felt, would be better suited to meet their, and our, common objectives. I won't take the time to go into the details of the differences, which basically had to do with how the system should be organized. I'll just mention that the great majority of the independent telephone companies, state regulatory commissions, and accounting firms that responded had similar objections and suggestions.

It's a little hard to tell right now how this proposed rewrite will affect our Functional Accounting project, because we just don't know what the FCC will do about our comments, and those of others. We won't know until some time this summer at the earliest. But we can speculate a bit.

With respect to the overall concept of Functional Accounting we think we're in pretty good shape. FA is quite flexible, and the FCC's proposal seems to have taken its existence into account.

Similarly, we think that the FCC's proposal, even in its original form, could be reasonably well accommodated by Stages I and II, i.e., with respect to terminal equipment. To be sure, a number of modifications would have to be made, but they do not look too difficult. There is, of course, another variable we must take into account, since these stages cover the terminal equipment portion of our business. If that business is deregulated by this legislation, as appears to be likely, we would need to revise the accounting system to take that fact into account. For example, I would expect that a deregulated terminal business would have to keep its books of accounts in accordance with what are known as Generally Accepted Accounting Principles (GAAP), rather than a Commission-prescribed USOA.

These GAAPs differ from the USOA in certain respects, including the treatment of certain costs that are capitalized under USOA rules but expensed under GAAPs.

Another important change would have to occur if present organizations were split into separate subsidiaries, each of which would, of course, have to have its own accounting system.

While we have not evaluated these factors fully, we see no insurmountable problems.

With respect to Functional Accounting Stage III, which, as I have mentioned, covers network services, the situation is much more murky. The pending USOA proceeding will, of course, have a profound effect on its eventual shape. Frankly, we do not know how to implement the originally proposed form of the revision. But, even if the FCC were to accept our general approach, there are innumerable details that would still have to be worked out. Thus, with respect to FA, III, we have a combination of a difficult theoretical accounting problem and the uncertainty of just what this system will have to accomplish in the regulatory arena. I would add to this the uncertainty being introduced by these bills, with respect to the organizational structure of the Bell System. You can see why I have described the situation as murky.

What is of great importance to us is the speedy resolution of the questions the FCC is now considering, so that we can get on with the job of planning, developing and implementing the last stage of Functional Accounting.

I realize that you would like to know when Functional Accounting can be completed, and I want to assure you that I would like to be able to tell you. But, given the uncertainties that I have just described, I am most reluctant to even estimate a date.

Well, what are some of the implications of what I have told you so far?

First of all, you recognize that the most difficult of all of these accounting problems is the allocation of plant that is jointly used by two or more services. The obvious way of solving that problem, and also the wrong way, would be not to use plant jointly. But there are good reasons for this joint use of plant.

The reason we use plant jointly for more than one service is because it's an economically efficient way of providing service. The result is lower prices for all services to the public.

The Bell System network is a prime example of jointly used plant. The efficiencies and economies of today's telecommunications services are to a large measure due to this joint use. Not only is it efficient to use microwave towers, ducts, buildings, data

processors, and other facilities in common, but it is the nature of modern transmission and switching systems that the larger they are, the more efficient they are, and the lower their unit cost. Therefore, if you can aggregate the demands of several services to use a single system, you can use a larger, more efficient, and thus lower-cost system, which will result in lower prices to the customers of all the services that are provided over these systems.

People have suggested separate subsidiaries as a way of preventing cross-subsidies. Unfortunately, that does not solve the problem of the joint use of plant that I have just been discussing. Unless each of the subsidiaries owned all of the facilities it needed to provide services—and this approach would forgo the economic advantages of joint use—you still have the problem of allocating to each of these subsidiaries the cost of the jointly used plant, and that requires an accounting system.

What I am trying to say is that a separate subsidiary is not a substitute for an accounting system. An accounting system may be a substitute for a separate subsidiary for the purpose of preventing cross-subsidies, but the reverse is not true.

There may indeed be other reasons one might want to set up a separate subsidiary, but with respect to the prevention of cross-subsidies this is not an adequate substitute, as long as there is jointly used plant.

Mr. Chairman, we do have an accounting problem today. We need to solve that problem. In order to solve the problem we need a new system for obtaining the numbers and we need clear direction as to the method to be employed for using these numbers to obtain costs of service. We are working on obtaining such a system, and so is the FCC.

What I am hoping, however, is that the problem is recognized for what it is and not solved in ways which would throw the baby out with the bath water. I do not believe that this legislation should require disaggregation of the facilities used for different services, and as I read the legislation, it does not. I also believe that the legislation should not mandate unnecessary separate subsidiaries just to solve the cross-subsidization problems. As I have tried to show, it does not do that, where there is joint use of plant.

In the meantime, we have a transition problem. In other words, what do we do until we implement this new accounting system we have been talking about?

There are a number of approaches that I believe we can take. It goes without saying, of course, that nothing should stand in the way of a speedy implementation of the revision of the Uniform System of Accounts. We are committed to that. We assume that so is the FCC. We recognize, however, that rulemakings involve certain unavoidable delays. This means that we need to provide for reasonable interim solutions to the problem.

The first approach involves interim so-called Cost of Service Record Systems, similar to the system we are developing, in accord with the agreement with the FCC, for the Digital Data Service (DDS). This record system relies on special sub-accounts of the Uniform System of Accounts for the detail needed to determine the costs of providing DDS—as if it were provided through a separate subsidiary.

Such cost-or-service systems, because they rely heavily on manual and ad hoc procedures, tend to be very cumbersome and expensive. We don't like to proliferate them. yet, when we filed a petition with the FCC relating to a proposed new service—Advanced Communications Service, or ACS—we offered to set up a similar cost of service record system, and we are proceeding on that basis. We would not preclude the creation of additional such systems for new competitive services, if necessary.

As a second approach, I would remind you of something I said earlier in my testimony, namely, that the part of Functional Accounting that pertains to terminal equipment is now being introduced into the telephone companies. I cannot give you a precise schedule, but we would try to accelerate this process to the extent possible. I don't know when this legislation will become law, but it may well be that we could have the terminal portion of Functional accounting in place in most of the telephone companies by then.

The third approach I would suggest goes to the fundamental problem we have been discussing. Accounting systems are a means to an end not an end in themselves. What is fundamentally at issue, it seems to me, is to assure the public, competitors, and regulators that competitive services are being priced so that they are not subsidized by non-competitive services.

In the inter-city services arena, this fundamental issue is at present involved in a relatively small number of important controversial tariffs. We obviously have an incentive to get these tariffs approved, so that we can get on with the business of offering service to our customers.

In a somewhat analogous situation, there were some very troublesome rate and cost issues involved in ENFIA. They were addressed and resolved after everyone

pitched in with an objective of obtaining "rough justice." I'm sure that nobody who participated in that process felt that it had the precision and polish we would all have preferred. Nevertheless, agreement was reached.

What I would suggest is that we approach the "interim" problem—what to do until the USOA has been revised and implemented—in that same spirit of "rough justice." We are prepared to work with the FCC staff and with interested parties to dispose of some of the issues that now beset the ratemaking process. Resolution of these issues will be necessary in any event—as part of the USOA rewrite—because many of the issues we have been discussing, perhaps the most important ones, are not really accounting issues as such. Rather, they go to the costing methodology, which has more to do with policy and philosophy than it has with accounting.

Furthermore, let me say that we are truly open to other ideas for resolving these matters expeditiously, with at least rough justice to all.

Let me now turn to still another issue in this area.

We, along with what I believe is the great majority of economists, think that Long Run Incremental Analysis is the appropriate way to determine prices. The FCC believes otherwise, and has insisted on a Fully Distributed Cost approach. I note that the House bill, HR.3333, contains a directive to the Commission to adopt what the Bill calls Long Run Marginal costing concepts as a basis for pricing. We commend that provision to your attention and would like to see a similar provision adopted by your committee. While I'm not the expert on that matter, I would be glad to arrange for material on it be furnished your staff.

Let me now turn to a matter that has cropped up repeatedly in these hearings—the matter of Bell Labs' and Western Electric's costs. In particular, there have been allegations of cross-subsidies from monopoly to competitive services which seem to have been based on fundamental misconceptions about how Bell Labs and Western Electric's operations are financed. More specifically, these allegations concerned improper use of license contract funds.

To be sure, this is a complex subject. I will, nevertheless, try to show that these allegations are without any foundation in fact.

To begin with, let me talk about Western's and Bell Labs' accounting systems.

Western and Bell Labs, since they are not carriers under the 1934 Act, do not fall under the Uniform System of Accounts. Indeed, since the USOA is specifically designed for telephone companies, it would be entirely unsuitable for a manufacturer like Western and an industrial laboratory like Bell Labs.

Instead, both of these entities use modern financial accounting systems that conform to Generally Accepted Accounting Principles. These systems have been repeatedly examined by various accounting firms during regulatory proceedings, and have been judged to be entirely suitable to their purpose.

Let me now try to explain to you, as simply as I can, how Western and Bell Labs are financed. Let me start with Western.

Very simply, Western is financed by the mark-up on the sale of its equipment and software—primarily to the Bell operating companies. The price to the telephone companies covers the raw material, the direct labor, the factory overhead, the development by Bell Labs and Western engineers, and other expenses—in short, everything needed to produce that piece of equipment or software.

Western has a superb cost accounting system to keep track of all of these costs. For convenience, in accordance with cost accounting principles that are generally accepted by any multi-product manufacturer, similar products are grouped into product lines. Development and other expenses are then applied to product lines and thereby to individual products. Not to use product lines would result in proliferation of record keeping that would have no purpose.

Thus, each piece of equipment or software sold by Western is made to carry all of the costs that went into producing it. All of Western costs are covered in that way. Western does not get any license contract money.

Notice that, since each product carries its own load of costs, it doesn't really matter whether the telephone companies use it to furnish monopoly or competitive services. The price charged by the *telephone companies* for each competitive service covers the cost of equipment used in that service.

Thus, there is no need for Western to classify the equipment it manufactures according to whether it will eventually be used in the provision of a monopoly service or a competitive service, or both, as is often the case. Indeed, in many cases, there is no way for Western to know just how a telephone company will eventually use a particular product.

To sum up, Western is financed through the sale of its products. Each product is priced to carry its own costs as determined by an accounting system that is appropriate for manufacturing.

One of these costs is Bell Laboratories product design. Before I tell you how that is paid for, I need to tell you about how Bell Labs is financed in total.

Leaving out the work it does for the government and some other minor funding mechanisms, Bell Labs is funded principally from three sources: Western Electric, AT&T, and direct payments from the telephone operating companies.

Authorizations for the work done by Bell Laboratories get extensive review by Bell Labs management and the funding source: Western, AT&T, or operating companies. In other words, work done for Western—for example, developing a PBX—is intensively reviewed, and must be approved, by Western as well as Bell Labs management.

Western, then, pays for specific design and development work done on Western products. The work is billed to, and paid for by, Western. The telephone company pays for these costs as part of the price it pays Western for products. Eventually, a customer pays it as part of the rate he is charged for the service that uses the product.

Thus, there is a chain of funds from customer to telephone company to Western to Bell Labs for the Laboratories' specific design and development work.

Another category of work at the Labs, consisting of the development of certain operational software systems for the telephone companies, is prorated and billed directly to each telephone company. This is the work on Business Information Systems. The telephone companies, in turn, recover this money from all customers through a general overhead loading factor as part of the rates they charge.

We now come to the most misunderstood part of Bell Labs, the work funded by the license contract.

First of all, I should explain what the license contract is.

It is one of the basic instruments that makes a telephone company a part of the Bell System. There is a fee—the license contract fee—that goes with that contract. The fee pays for the work done by the AT&T General Departments and for some work—I repeat *some* work—done by Bell Labs.

The work at Bell Labs paid for under the license contract falls roughly into two categories: basic research and systems engineering. The license contract does *not* pay for development of products. As I explained earlier, development of products is paid for by Western Electric.

Research is designed to advance our knowledge in the arts and sciences related to telecommunications and information handling.

Systems engineering, which is also paid for by license contract funds, is what makes the network hang together technically. Dr. Ross will tell you more about Bell Labs research and systems engineering.

Where do the telephone companies get the license contract money? Just like all other moneys required to give service, this money comes from the customer.

The charges for each service a telephone company offers include a contribution to the license contract. This is true for competitive services as well as for the so-called monopoly services. Customers for Dimension PBX, customers for private line service, and customers for basic service each pay a share.

The reason is that they all benefit from this work, and should therefore pay for it. The implication that, somehow, the customer for competitive services gets some kind of a "free ride" on the license contract, any more than he gets a free ride on other expenses such as taxes, is simply based on a false premise.

Broad allegations are sometimes made that the license contract pays for Western Electric development. As a general proposition, this is simply not so, as I have just explained. But sometimes, a less sweeping, but equally incorrect, allegation is made. It is alleged that some work paid for under the license contract is done for Western's benefit, and should be paid for by Western. This allegation was made by the staff of the California PUC, which has not ruled on the issue, and has since cropped up second-hand in various hearings, including last week's hearings before this committee. I was a witness in that proceeding and would be glad to make available to this committee the testimony we filed completely rebutting these allegations.

Just to sum up the matter of Bell Labs financing let me trace the three sources of funds backwards from the customer who ultimately pays.

Let's say a customer subscribes to Dimension PBX service. His bill for that service includes a certain amount that will eventually reach Bell Labs. It will get there in three distinct ways. First, an amount is paid directly by his serving telephone company to Bell Labs for development of the so-called Business Information Systems. Second, an amount is paid by the telephone company to AT&T under the license contract; some of that is, in turn, paid to Bell Labs for work on research and systems engineering. And finally, there is an amount that pays for the equipment that had previously been bought by the telephone company from Western. The price the telephone company had paid Western for that equipment included a factor for

development, which Western had paid Bell Labs. So, in effect, the customer is reimbursing his serving telephone company for money that had previously reached Bell Labs through Western.

I hope that this rather involved explanation has made it clear why the issue of potential cross-subsidies and accounting systems which is looming so large in these hearings, is confined to the telephone companies. Western and Bell Labs have good cost-accounting systems. These can be, and have been, examined by regulatory agencies. If adjustments need to be made to these systems they can be made, if necessary.

Finally, let me sum up.

First, we agree that competitive services should not be cross-subsidized by non-competitive services.

Second, we know that we need better cost accounting systems in the telephone companies for that, and other, purposes. And we have been working diligently for a number of years, and have spent hundreds of millions of dollars toward that end.

Third, we do not object to the establishment of subsidiaries where they make economic and management sense. But it must be possible for these subsidiaries to be managed, and to operate with other affiliates within the horizontally and vertically integrated Bell System structure.

Fourth, we know that there exists a problem with respect to how we will work in the interim. I have given you some suggestions relating to interim cost-of-service record systems, implementation of Functional Accounting for terminal equipment, and an approach to achieving a "rough justice" solution. And I have indicated our willingness to consider with an open mind other approaches that might be suggested.

Fifth, I have tried to sketch for you the situation with respect to Western Electric and Bell Labs accounting systems in order to suggest that these do not pose any particular problem.

Let me conclude by thanking the committee for the opportunity to discuss this crucial aspect of the matters before you. I would be surprised if I had left you without any unanswered questions, and will do my level best to answer any you may have.

Senator HOLLINGS. Mr. Grant.

Mr. GRANT. Thank you, Mr. Chairman and Senator Goldwater.

Because of previous appearances, as you know, I am Gus Grant, president of Southern Pacific Communications Co.

We submitted a statement for the record on April 25 containing our overviews of the two bills. We applied the objectives and goals and findings of both S. 611 and S. 622 and endorsed the attempts to amend the Communications Act of 1934 in ways designed to make it more suitable to the technological trends of the last 20 years of the century.

We believe a competitive telecommunications industry is the best means to realize the promise that advancements in technology offer. Competition will also insure the provision of varied high quality communications services to the public at the lowest practical cost.

We welcome this opportunity to appear on the panel discussing the structure of telecommunications, because it is the existing structure, the structure today, which is the heart of the present debate.

Unless the structure and related behavioral issues are properly resolved the laudatory goals of this legislation will never be adequately accomplished.

We have three reasons for recommending the adoption of the structural safeguards shown in the legislation.

First, the sheer size and power and particular organization of A.T. & T. Second, regulation alone is inadequate to police behavior, given their size and organization and experience.

Third, structural reform in the form of separate subsidiaries creates arm's-length relationships that improve the possibility of detecting collusive behavior.

It's indisputable by any set of standards that you wish to use such revenues, profits, asset base, number of employees, that the A.T. & T. overwhelmingly dominates the domestic common carrier market.

In addition, they have established an integrated organizational structure that facilitates its control over all relevant communications markets. Through its operating companies A.T. & T. provides local service to 85 percent of the phones in the United States.

They cover only 50 percent of the area of the United States, incidentally.

Through its long distance department it provides a substantial part of all intercity transmission services.

Through Western Electric it supplies a substantial portion of all of the communications equipment, and it invests most of the capital required to maintain the Nation's communications.

The Bell System represents a truly unique organization, which occupies both monopoly and competitive markets, utilizing largely fungible facilities, providing both intrastate and interstate services with these common facilities, and controls its principal equipment supplier.

This structure provides the Bell System with the opportunity to control the visible costs of the bulk of its physical plant through its control of Western Electric.

To control the allocation of those costs as between intrastate and interstate services, control the allocation of those costs as between monopoly and competitive services, and to establish terms and conditions under which a central monopoly services and facilities provided by its subsidiaries and operating companies will be made available to entities competing with the long lines competitive services.

Through a number of processes like separations and settlements procedures and various licensing arrangements, A.T. & T. dominates the entire telephone industry, including those portions it does not directly own.

Thus the economic conditions, essentially, for a truly competitive market—that is, the presence of a number of firms, no one firm able to dominate the market by itself—don't yet exist.

Let there be no mistake as to the benevolent nature of the dominant participant. Southern Pacific like 39 or so other corporations found their conduct in the marketplace so unacceptable that we have had no choice but to file a private antitrust suit against A.T. & T. We sincerely believe the Justice Department is correct in its Government antitrust suit against A.T. & T., when it states that A.T. & T. has illegally monopolized the markets for telecommunications service through a deliberate and persistent pattern of exclusionary behavior.

It is because of A.T. & T.'s tremendous incentive and ability to monopolize all of the markets that the Justice Department seeks both injunctive relief and industrial reform of A.T. & T. as the only means to eliminate A.T. & T.'s existing inherent structural incentive and ability to thwart competition. Thus we believe it's appro-

priate for Justice to seek the separation of A.T. & T. and its ownership of interstate facilities from its ownership of local facilities, in order to eliminate the incentive and ability of a joint provider of intercity and local services to deny or delay the ability of new entrants for providing competing services.

All intercity transmission and switching facilities of the current Bell network should be separated from the local facilities of the Bell-operated companies.

We welcome the remarks delivered by chairman of the board Charles L. Brown of A.T. & T. during the opening day of the hearings on April 24, when he stated private antitrust suits should be allowed to go forward. I quote, "If we have behaved in a fashion which is illegal, then we should go to trial and should thrash that out." Unfortunately, Mr. Brown is asking the Congress to grant his company immunity from the antitrust laws of the United States by urging you to save him from what he calls the tender mercies of the Justice Department.

He does this by making the statement that S. 611 and S. 622 are dealing with the horizontal and vertical structure of the Bell System, and thus when legislation is passed, all structural remedy issues will have been sufficiently and effectively resolved.

S.P. Communications believes that such a view is a gross misreading of the present legislation.

Further, we believe it's proper for A.T. & T. like other corporations to be subjected to antitrust remedies, including structural relief for past and present behavior which violate such laws.

S.P. Communications believes S. 611 provides a behavioral and organizational remedy to the present market condition.

We have stated earlier we welcome the behavioral and organizational reforms, but continue to believe that a major restructuring—that is ownership divestiture of A.T. & T.—may be the only remedy which will adequately prevent them from illegally cross-subsidizing and making other anticompetitive actions.

S.P. Communications recommends Congress pass legislation which would, one, separate the management of A.T. & T. intercity services and facilities from intraexchange services and facilities.

Two, separate A.T. & T. intercity services in a manner whereby services subject to effective competition are in one entity, while services not subject to effective competition are in a separate entity.

For this approach to be effective, A.T. & T. long distance should be established as a separate entity. This would require that truly independent directors, management, financing, assets, and employees, as well as nonpreferential access charges and interconnections be established for the separate entity, as well as all of the other separate entities.

Independent financing is crucial, as this would, first, help assure separation from the deep pocket of the parent and, second, aid in exposing improper intracompany transfers or cross-subsidies.

Such a separation of entities, combined with an adequate uniform system of accounts, cost allocation methodology, division of revenues plan, along with evenhanded regulation of services not subject to effective competition, will provide the basis for moving toward the establishment of full and fair competition.

Mr. Chairman, in my final seconds let me raise one other point. The other day during the testimony you made reference to the fact that A.T. & T. has 26 separate subsidiaries and that, therefore, the requirement to establish one more doesn't seem to create any kind of major burden for A.T. & T.

We concurred in your thought and went back and attempted to research how many subsidiaries A.T. & T. had.

What we discovered was that A.T. & T. has 63 separate subsidiaries as shown on this chart.

The chart illustrates the breakdown of these subsidiaries as we see them.

It might not be fully correct, but that is as we see it.

Obviously, most of these subsidiaries are minor and don't affect the day-to-day operations.

The point is that adding one or two more would not pose an insurmountable problem.

What is critical is that the new subsidiary or subsidiaries which should be required to have to be established as fully-separated entities within the definition of S. 611.

On the overlay of the chart we show the two fully-separated entities which we believe are the minimum which must be established in order to bring about fair competition in the intercity area. We probably need a new chart more than anything else.

Thank you.

[The statement follows:]

STATEMENT OF C. GUS GRANT, PRESIDENT, SOUTHERN PACIFIC COMMUNICATIONS Co.

Mr. Chairman and members of the subcommittee, I am C. Gus Grant, president of S.P. Communications Company, a wholly owned subsidiary of the Southern Pacific Company.

S.P. Communications Company submitted a statement for the record on April 25, 1979, containing our overview comments on S. 611 and S. 622. As we stated then, we applaud the objectives, goals and findings of both S. 611 and S. 622 and wholeheartedly endorse these attempts to amend the Communications Act of 1934 in ways designed to make it more suitable to the technological trends of this last 20 years of the 20th century. We firmly believe that a competitive telecommunications industry is the best means to realize the promise that advancements in technology offer. Competition will also insure the provision of varied, high quality communications services to the public, at the lowest practical cost.

We welcome this opportunity to appear on a panel discussing the structure of the telecommunications industry because it is the existing structure which is the heart of the present debate. Unless the structure and related behavioral issues are properly resolved, the laudatory goals and findings will never be adequately accomplished.

We have three reasons for recommending the adoption of structural safeguards in legislation:

1. The sheer size, power and particular organization of AT&T.
2. Regulation alone is inadequate to police behavior given their size and organization.
3. Structural reform—in form of separate subsidiaries—creates arms-length relationships that improve the possibility of detection collusive behavior.

It is indisputable, by any reasonable measure of revenues, profits, asset base, number of employees or market share that AT&T overwhelmingly dominates the domestic common carrier transmission and equipment markets. In addition, AT&T has established an integrated organizational structure that facilitates its control over all relevant communications markets.

Through its operating companies, AT&T provides local service to about 85 percent of the phones in the United States. Through its long lines department, it provides a substantial part of all intercity transmission services. Through Western Electric, it supplies a substantial portion of all equipment used by customers and the family of

Bell companies in the provision of communications services. It invests most of the capital required to maintain and expand the Nation's Telecommunications Plant.

Thus, the Bell System represents a unique organization which occupies both monopoly and competitive markets, utilizing largely fungible facilities; providing both intrastate and interstate services (also with common facilities); and which controls its principal equipment supplier.

This structure provides the Bell System with the opportunity to:

(a) Control the visible costs of the bulk of its physical plant, through its controls of Western Electric;

(b) Control the allocation of those costs as between intrastate and interstate jurisdictions;

(c) Control the allocation of those costs as between monopoly and competitive services;

(d) Establish the terms and conditions under which essential monopoly services and facilities provided by its subsidiary operating companies will be made available to entities competing with the long lines competitive services.

Further, through a number of processes, like the separations and settlement procedures and various licensing arrangements, AT&T dominates the entire telephone industry, including those portions it does not directly own. Thus, the economic conditions essential for a truly competitive market—the presence of a number of firms with no one firm able to dominate the market by itself—do not yet exist.

Let there be no mistake as to the benevolent nature of this dominant participant. Southern Pacific like 39 or so other corporations, has found their conduct in the marketplace so unacceptable that we had no choice but to file a private antitrust suit against AT&T. We sincerely believe that the Justice Department is correct in its Government antitrust suit against AT&T when it states:

"AT&T has illegally monopolized the markets for telecommunications services and for telecommunications equipment through a deliberate and persistent pattern of exclusionary behavior. This pattern or behavior has been made possible through the coordination of all the constituent parts of the integrated Bell System."

It is because of AT&T's tremendous incentive and ability to monopolize all the markets in which they operate that the Department of Justice seeks both injunctive relief and structural reform of AT&T as the only means to eliminate AT&T's existing inherent, structural incentive and ability to thwart competition. Thus, we believe it is appropriate for Justice to seek the separation of AT&T's ownership of intercity facilities from its ownership of local facilities in order to eliminate the incentive and ability of a joint provider of intercity and local services to deny or delay the ability of new entrants from providing competing services. All intercity transmission and switching facilities of the current Bell network should be separated from the local facilities of the Bell operating companies.

S.P. Communications welcomes the remarks delivered by AT&T Chairman Charles L. Brown, during the opening day of hearings on April 24, 1979, when he stated that the private antitrust suits should be allowed to go forward:

"If we have behaved in a fashion which is illegal, then we should go to trial and we should thrash that out."

Unfortunately, Mr. Brown is asking the Congress to Grant to his company immunity from the antitrust laws of the United States by urging you to save him from what he calls "The tender mercies of the Justice Department." He does this by making the statement that S. 611 and S. 622 are dealing with the horizontal and vertical structure of the Bell System and thus when legislation is passed all structural remedy issues will have been effectively resolved. S.P. Communications believes that such a view is a gross misreading of the present legislation. Further, we believe it is proper for AT&T, like other corporations, to be subjected to antitrust remedies, including structural relief for past and present behavior which violates such laws.

S.P. Communications believes S. 611 provides a behavioral and organizational remedy to the present market condition. As we have stated earlier, we welcome the behavioral and organizational reforms but continue to believe that a major restructuring, that is, ownership divestiture, of AT&T may be the only remedy which will adequately prevent them from illegally cross-subsidizing and making other anticompetitive actions.

S.P. Communications therefore recommends that Congress pass legislation which would: (1) Separate the management of AT&T's intercity services and facilities from intraexchange services and facilities and; (2) Separate AT&T's intercity services in a manner whereby services subject to effective competition are in one entity while services not subject to effective competition are in a separate entity.

For this approach to be effective, AT&T long lines should be established as a separate entity. This would require that truly independent directors, management,

financing, assets and employees, as well as nonpreferential access charges and interconnections be established for the separate entity. Independent financing is crucial as this would (1) help assure separation from the deep pocket of the parent and (2) aid in exposing improper intra-company transfers or cross-subsidies.

Such a separation of entities, combined with an adequate uniform system of accounts, cost-allocation methodology, division of revenues plan, along with even-handed regulation of services not subject to effective competition will provide the basis for moving toward the establishment of full and fair competition.

If the Congress elects not to fully undertake the necessary studies leading to a major restructuring at this time, we believe the bill should provide for a review of this subject at the end of five years. Secretary Geller during his testimony properly pointed out that this area can be restudied then the light of the intervening experience.

Senator HOLLINGS. Mr. Schnee?

Give Mr. Goldstein a chance to look at that. We want his comments.

You look at that. We will come back to you, Mr. Goldstein.

Mr. SCHNEE. Mr. Chairman, members of the committee:

I am appearing here at the request of the committee staff. At the outset, let me point out that this appearance was totally unsolicited by us at Probe Research. We did not have a proposal we wished to make for legislative consideration. However, we are only too pleased to appear here to assist in discussing the restructuring of the industry, and particularly the separated entity plan proposed in S. 611. The other members of this panel represent companies and organizations with well-known interests in telecommunications. By contrast, we are an independent research organization with no ties, financial or other, to any party in this legislative controversy. We represent no vested interest.

We do have a deep interest in the industry, and the issues of competition and industry structure. For those not familiar with our work, let me say that 2½ years ago, we published a book entitled, "The Future of A.T. & T.," which was the most comprehensive, and most carefully documented study of A.T. & T. ever published. The book received wide acclaim in the industry and in the press, and it was read by telecommunications authorities, not only in the United States and Canada, but Japan, Europe and Third World countries as well. As the American Banker just stated on April 25, 1979, "The Future of A.T. & T.' became a widely used basic primer on the communications giant and * * * contained many projections that have come true."

We regularly publish a quarterly journal devoted to competitive issues and new technologies. And we publish other in-depth studies. Recent studies which are relevant to competitive issues include: A 250-page study of the impact and future markets for fiber optic communications in the telephone industry, to 1990, a 145-page study on the digital future of the telephone network, a 65-page study of A.T. & T.'s entity proposal for equipment purchasing made to the FCC, a 35-page study of the new equipment purchasing procedures of GTE under the ITT-GTE consent decree, a 67-page study of A.T. & T.'s price comparison studies and their use in competitive equipment purchasing, a 30-page study of how A.T. & T. funds research and development expenses through its license contract, a 50-page study of how the A.T. & T. general departments operate, a 42-page study of the use of tax benefit financing subsidies to fund A.T. & T.'s capital expenditures. We have also published in-depth articles on the U.S. antitrust suit

against A.T. & T., legislative proposals, and various FCC and other regulatory proceedings.

Against that background, we have reviewed S. 611 and S. 622. At the outset, the legislation makes a strong statement in favor of competition as the primary goal for structuring the telecommunications industry. This, in our view, is a very sound objective. The question is, of course, do the measures dictated by the legislation constitute sound steps in favor of that objective.

Assuming the establishment of the fully separated entity or entities, by A.T. & T., a number of questions could be raised. For example, are there effective sanctions in the legislation, including the 1934 act, which would allow the FCC to enforce the arms-length standard of dealing?

However, we would like to concentrate on certain financial aspects of the entity proposal. It is unfortunate that there has been no attempt to draw up a preliminary financial model of what it would look like in dollars and cents terms.

For example, on a rough basis, we estimate that putting the interconnect equipment business of A.T. & T. and its private line business into the entity would produce revenues of about \$4 billion. Other activities could increase this number very sharply. For example, if the FCC changes the accounting rules under which telephone installation costs are capitalized, and there is a proposal before the FCC by A.T. & T. along these lines, and if the installation business became competitive, several billion in revenues could be added to the entity. If the entity became a marketing arm for Western Electric transmission and switching equipment, another \$2 to \$3 billion in sales could be added.

The entity, in other words, could be an extremely significant business organization, perhaps dwarfing all others in the industry besides A.T. & T. itself.

In view of these facts, we think it is unfortunate that the legislation does not provide for very clear breakdowns of the various activities of the entity. Furthermore, as we read the bill, there is no surveillance called for regarding the relationship of Western Electric and the entity.

However, leaving these points aside, deeper issues revolve around the financing question. Competitive companies in this capital-intensive industry typically depend critically upon the financial marketplace to raise capital.

This new entity, however, will get its equity money from the monopoly business. This means that A.T. & T. raises money through its earnings or its stock or its credit, or through the subsidies it receives every year, which I'll discuss in a moment.

Now, what happens if the entity company sells or leases PBX's below cost? It will lose some money—which will be difficult to trace because the entity contains several lines of business.

Furthermore, if the entity needs more money, it goes back to the A.T. & T. monopoly for money.

As you can see, what I am suggesting is that we have transferred the cross-subsidization evil downstream, but it's still there. Furthermore, in a single, multiline entity, it's going to be difficult to identify.

Now one might think that ultimately the stockholders of A.T. & T. are some sort of restraining force, if the investment in the entity mounts up and it is losing money. But my preliminary observation is that this practice could go on for many years before it would raise questions on the investor level.

The nub of the problem is that unless the purse string is cut or controlled, the anticompetitive bias of an affiliated entity is hard to protect against.

This leads us back to that word which is raised over and over again in discussing industry structure, which is divestiture. Under divestiture the resulting competitive entity or entities must stand on their own feet financially. This, I fear, is not the case with the fully separated entity concept.

As we have reflected more and more deeply over the problems of competition in telecommunications, we have found that the question of capital allocation—who gets it, how much, and at what cost—is often at the root of the competitive problem. In other words, it isn't just a question of who is allowed in the PBX business, or who is allowed to provide packet switched networks.

An equally important, even more important question is, what access do they have to the capital markets, and is the process rigged in favor of certain participants. The fact is that the Bell system has priority access to the capital markets.

If I were to try to sum up a standard for judging this legislation, if passed, I would say the legislation was a success if it gave to the Bell system a right which Bell has never enjoyed. That is the same right which every other industry competitive company has—namely the right to fail—at least the right to fail in its competitive activities.

We who have studied the subject, have seen repeated instances where the Bell system—caught off balance by competition, or by its own mistakes, simply pours the rate payers' money in to extend or protect its market position. We've seen it with multihundred million dollar failures, such as Picturephone, we've seen it with crash projects, such as catching up in PBX's where in their own internal memos, they admit they sadly neglected the business for several years. But the money is always available. There never is truly failure as a company like Datran experienced, or as MCI might have experienced if the money ran out.

Now, we're not wishing failure on A.T. & T. and we're not saying they shouldn't respond to challenges. But when one company has virtually unlimited, priority access to the capital trough through monopoly activities, we believe the whole competitive process is distorted.

There is a supreme irony here. As serious as the capital allocation problem is, and as central as it is to telecommunications competition—the fact is the problem has been greatly exacerbated by legislation passed by the U.S. Congress. This legislation grants subsidies to A.T. & T. which make it the most heavily subsidized company in U.S. history. The subsidies also apply to other telephone companies and some other utilities, but the really big dollars go to A.T. & T.

Last year, 1978 alone, A.T. & T. received \$2.2 billion through this subsidy. This is money on which it pays no return—no dividends,

no interest to anyone. Since 1969, the company has received, return-free, about \$11 billion of subsidies.

The subsidies are buried in technical provisions of the Internal Revenue Code. However, in 1977 we wrote a 42-page analysis of the problem which has remained unchallenged. Our study was reported by Business Week on April 17, 1978, in an article in which A.T. & T. agreed with my estimate, that absent regulatory or legislative intercession, the total cumulative credits could grow to \$25 billion by 1982. The problem remains uncorrected except for an isolated action by regulators in California.

Now, I did not come here just to raise clouds about this legislative endeavor. I view it, unequivocally, as an important attempt to instill competition in telecommunications.

We've asked ourselves, are there any suggestions we can make which could be helpful to this effort? Respectfully, I'd like to make two suggestions:

First, I suggest that the committee undertake a formal attempt to develop a preliminary financial model of the fully separated competitive entity. We think it will be very helpful to identify the magnitude of dollars involved in terms of sales, assets, and investment. It will help in anticipating the potential for cross-subsidization and may suggest some safeguards.

Second, we suggest that some consideration be given to the tax benefit financing subsidy as it affects the issue of competition and this legislation. We believe this will lead to a fuller understanding of the competitive problems of the industry, and the financial pitfalls which may await this legislation. We surmise, of course, that remedial legislation on the tax benefit subsidy issue is apparently not the function of this committee.

This bill, S. 611, as well as S. 622, has been described by committee members, accurately we believe, as a transition step. Certainly, it is aiming in the right direction. It has some good elements. We are trying to be helpful in the process, and we hope we have fulfilled the staff's expectations in inviting us here.

Senator HOLLINGS. Thank you, sir.

Mr. Harcharik.

Mr. HARCHARIK. Mr. Chairman, members of the subcommittee:

I am Robert Harcharik, president of Tymnet, Inc., a resale data communications common carrier, certificated by the FCC. Tymnet is a wholly owned subsidiary of Tymshare, Inc. Tymnet's corporate headquarters is located in Cupertino, Calif.

Tymnet is fully committed to the philosophy, articulated in S. 611 and S. 622, that fair competition is the best mechanism for assuring the development and delivery of sophisticated, diverse, quality telecommunications services. I believe, in particular, that S. 611 properly builds on the existing regulatory structure by adding flexibility and directing the Commission to encourage competition. I believe that it strikes the right balance between fair competition and the need to regulate where such fair competition cannot or does not exist.

S. 611 is a subtle and sophisticated approach to the solution of a variety of complex problems. Because of the intricacies of the interrelationships between various sections of this legislation, we believe that care should be taken that tinkering does not unbalance a

whole series of carefully crafted relationships which are critical to the intent of this legislation. Nonetheless, Tymnet has several specific suggestions about amendments to sections of the bill which, with the chairman's permission, we wish to submit to the committee before the record on this matter closes.

Today, however, at the committee's invitation, I would propose to discuss the broader questions of industry structure. Simply stated, Tymnet has concluded that it is absolutely essential that carriers enjoying monopoly power offer competitive service only through fully separated arms-length subsidiaries.

Frankly, I believe that Tymnet offers the sophisticated and innovative communications services which S. 611 and S. 622 intend to encourage. Specifically, Tymnet was developed to meet needs which were not being met by the traditional carriers. Tymnet's communications network evolved from the private shared network of Tymshare, Inc., a computer services company, which provides a wide variety of data processing services. After Tymshare was founded in 1965, it recognized the limitations that the voice telephone network imposed on data transmission, and undertook to design a reliable efficient communications system for its own use. In 1969 it installed communications processors of its own manufacture and design which enabled Tymshare to obtain more efficient utilization of its facilities and to achieve significant reductions in transmission errors.

In 1972 the National Library of Medicine, which had initiated an on-line bibliographical retrieval system for the biomedical community, became a joint user of Tymshare's national data communications facilities. Thereafter, the number of the joint users increased to 34.

The company found that its ability to expand service to existing users and to offer service to new users was restricted. Therefore, Tymshare founded Tymnet in 1976 as a separate common carrier subsidiary and sought and received Commission authorization to provide a resale data communications service to 61 cities in the continental United States. Today, less than 2 years later, Tymnet offers service in over 150 cities. The service allows users to interconnect virtually any terminal, a wide variety of computers and entire networks employing totally different protocols. Tymnet has interconnection agreements with the international record carriers and Canada's Datapac which makes the service available in over 20 foreign countries. It is Tymnet's technology that is being used by the postal, telephone and telegraph authorities in these jurisdictions.

If indeed imitation is the sincerest form of flattery, Tymnet is getting its fill of flattery from the traditional monopoly carriers. In July of last year, A.T. & T. filed a petition for declaratory ruling which would have authorized it to offer its advanced communications service, which is very similar to Tymnet's service offering. In December of last year, GTE, the second largest carrier, announced that it intended to acquire Telenet Communications Corp.—the only carrier presently competing with Tymnet. Obviously, we rapidly became quite interested in the industry structure under which monopoly carriers could or should offer resale or value added data communications.

We undertook an extensive review of the history of monopoly carriers' responses to other competitors and the manner in which they proposed to compete with us. Frankly, what we saw was both alarming and depressing. A review of the FCC's orders and the opinions of the various courts, which have considered the offering of competitive services by monopoly carriers, revealed that those carriers have not competed fairly in the past, and that the current regulatory structure is not wholly capable of halting practices which the Commission and courts have found to be unlawful.

As a matter of corporate policy, and as the record will show, Tymnet has relied on technology and service and not on the regulatory process to achieve its success. However, since our review of A.T. & T.'s ACS filing, and the filings of GTE with regard to its acquisition of Telenet, we have realized that industry structure is vital to the question of whether competition can continue to exist in the resale data communications market. This review, coupled with Tymnet's experience over the last 9 months in its dealings with competitors, leads us to one conclusion—competing with a monopoly carrier offering competitive services on an integrated basis will be like being in a street fight with a man who has the battery to your pacemaker in his pocket.

In other words, we are convinced that the monopoly carriers will continue to use their economic power and control of facilities, which are vital to Tymnet, to unfairly aid their competitive offerings and, ultimately, destroy the possibility of competition.

One of their most effective tactics has been to file noncompensatory rates for competitive services and to cross-subsidize competitive services from monopoly revenues. The committee should be aware that since 1971, when the Commission authorized competition in its specialized common carrier decision, not a single A.T. & T. tariff offering of a major competitive service has, upon investigation, been found to be lawful: the high/low tariff was declared unreasonable, the MPL tariff was rejected, the WATS tariff was rejected, the DDS tariffs have been considered and rejected four times, and a number of terminal equipment tariffs are still under investigation.

I am aware that last week Mr. Charles Marshall of Illinois Bell argued that A.T. & T.'s detailed accounting system would provide sufficient safeguards against cross-subsidization, and Mr. Brown made much the same argument. Unfortunately, that is just not so.

The Commission has admitted that its current accounting system does not retrieve the type of information necessary to detect cross-subsidization. Consequently, the FCC has undertaken to revise the Uniform System of Accounts. While A.T. & T. is arguing here that all that is needed is detailed accounting, in the USOA proceeding it is arguing against the kind of complete disaggregation of costs and revenues which many parties believe to be essential. Further, one witness before this committee has testified that the revision will not be ready and in place for 10 years. While that estimate may be unduly pessimistic, I believe that even the revised USOA will not in and of itself prevent cross-subsidization. The problem is not just in determining that a rate is unlawful, but is, as we shall see, in enforcing that determination.

A.T. & T.'s claim that it will develop an accounting system that will retrieve and properly attribute costs, must be greeted with a great deal of skepticism. Since 1971 its cost and rate methodologies have not generated lawful competitive rates. The DDS rates are the classic example of how A.T. & T. reacts to an opportunity to develop a cost of service records system for competitive services. As early as 1974, the Commission indicated that A.T. & T.'s DDS rates were not adequately supported. It was not until 1977 that the FCC rejected the rates and ordered A.T. & T. to file revised rates. It also ordered A.T. & T. to develop a cost of records system equivalent to a system under which a separate entity would offer DDS. In other other words, A.T. & T. was ordered in 1977 to do what it says it will do now.

In 1978 the Commission reviewed the new tariffs submitted by A.T. & T. and rejected them. Furthermore, the Commission concluded that the DDS cost of service records system is unauditable. Unfortunately, during this lengthy process, Datran, A.T. & T.'s major competitor in DDS, went bankrupt. Seven years after A.T. & T. applied for authority to offer DDS, it still has not filed lawful tariffs for this service. It has not even developed a cost system from which such tariffs could be derived, nor has it said when it will.

As you can see, A.T. & T. does not have a track record with cost systems which would inspire confidence. We believe that a separate subsidiary with a separate financial structure, would, however, eliminate much of the incentive for cross-subsidization, avoid the need to rely on A.T. & T.'s good intentions, and would substantially lessen an otherwise impossible regulatory burden.

The separate arms-length subsidiary structure should not, however, be regarded merely as an accounting system. It also prevents the carrier, enjoying a monopoly power, from abusing its control of vital facilities—the batteries upon which Tymnet relies.

Tymnet, of course, secures all of its channels from underlying carriers. It spends approximately 30 percent of its total expense budget on these communications services. Obviously, we are concerned that underlying carriers will discriminate against us, since, in the past, when faced with competition, the monopoly carriers have imposed a variety of discriminatory interconnection requirements on competitors. It happened with cable TV, it happened for 5 years to the specialized carriers, it happened to the domestic satellite carriers, and it happened to terminal equipment vendors. We believe a separated arm's-length subsidiary for competitive services reduces the incentive to impose discriminatory restrictions, makes it easier to identify and correct them when they exist, and thus reduces the regulatory burden.

The committee must understand that the problems I have detailed are not merely of historic interest. As I told you, the recent ACS filing illustrates that A.T. & T. continues to employ the same old discredited policies. An analysis of that filing reveals, for example: (1) Just as in DDS, A.T. & T. sought permission to offer ACS while refusing to provide the illustrative rates required by the Commission's rules; (2) A.T. & T. has stated that, for ratemaking purposes, it will cost facilities used in ACS on the basis of the unauditable cost systems from which the recently rejected DDS

rates were derived; (3) Even though A.T. & T. will utilize employees which market and sell the monopoly services to market and sell ACS—a patent illustration of cross-subsidization—A.T. & T. itself projected that ACS would not recover startup costs and the appropriate rate of return for 6 years; and (4) while A.T. & T. stated that ACS would be offered in DDS cities, 19 of the first 100 cities targeted for initial service are not authorized DDS cities. The only remarkable thing about the choice of these 19 cities is the fact that Telenet and Tymnet have local access in those cities.

I find most disturbing, however, the fact that the service provided to Tymnet by A.T. & T. has deteriorated over the last 6 to 9 months. Prior to the middle of last year, Tymnet received excellent service from A.T. & T. A year ago A.T. & T. was meeting 90 to 95 percent of the due dates for installation of lines. Today, they are meeting only 60 to 65 percent of the due dates. It appears that in some cases, Tymnet's customers can get lines more rapidly than Tymnet can. There has also been at least one recent delay with respect to GTE services.

Obviously, Tymnet cannot say that the deterioration in service results from the decision of these monopoly carriers to enter the resale data communications market. It appears to me, however, that the only way of assuring that facilities will be made available to competitors on a nondiscriminatory basis, is to require that competitive services are provided by an arm's-length subsidiary.

The history of monopoly carriers' reaction to competition, and our recent experiences, has lead Tymnet to conclude that the center piece of this legislation is the requirement that monopoly carriers offer competitive services only through fully separated arm's-length subsidiaries. This structure is flexible and nonpunitive. It encourages innovation and limits the need or regulatory involvement in competitive services. We endorse and support it.

Thank you.

Senator HOLLINGS. Well, Mr. Goldstein, before we give you a chance to rebut, let me ask Mr. Schnee of Probe Research, as an independent research organization how is Probe Research financed?

Mr. SCHNEE. It is financed completely by the principals and by our revenues.

Senator HOLLINGS. Does it work for all kinds of communications?

Mr. SCHNEE. Yes. Our reports cover the widest possible range, our customers run from the Bell System, U.S. Government on down to the small participants in the industry.

We have quite a number of clients overseas as well.

Senator HOLLINGS. I am not doubting you. I'm wondering, the cost of all these studies, you say the first thing we should do is get a model.

I don't know whether Chairman Cannon would allow us to employ that big a staff around here to try to break down A.T. & T. I don't know whether a 6-year term is sufficient for a Senator to talk about building a model up here.

We just have to move in as best we see fit. Who asked for these studies and who paid for these studies?

Mr. SCHNEE. We have paid entirely. None of our costs were paid by anybody.

We have never been financed or subsidized by anyone. It was all paid out of the pockets of the principals of the company and the proceeds of what we have been able to sell.

We look at ourselves as people who have tried to build a business, doing something we think we know how to do.

Senator HOLLINGS. How long has Probe Research been in business?

Mr. SCHNEE. As a formal entity, it was in business about 2½ years or so. The work had been going on for sometime prior to that before we actually started as an entity.

Senator HOLLINGS. Mr. Goldstein, have you had a chance to look at the chart where Mr. Grant spoke of 63 subsidiaries? Do you find anything unfair or improperly reflected?

Mr. GOLDSTEIN. No, Mr. Chairman. I learned something this morning. Some of these I didn't know about. I did know about the Manufacturers' Junction R.R., which constitutes, I believe, 8 miles of track between the Hawthorne works at Western Electric and the main line.

I have no question that this is probably an accurate chart. I would like to comment on that if you don't mind.

Senator HOLLINGS. Surely.

Mr. GOLDSTEIN. There are two areas of comment.

The first one pertains to the two additional subsidiaries on the overlay. While I think one can read the bill as requiring only those two subsidiaries, there are, of course, some practical problems. I believe some of these practical problems with respect to the bondholders have been alluded to in prior sessions of this subcommittee so we may, in fact, be talking about more subsidiaries than that.

There may be some subsidiaries of operating companies rather than national subsidiaries as have been indicated there.

But that brings me to the next point. We do have a lot of subsidiaries. We couldn't run the business without these subsidiaries.

I don't think two or four or even more subsidiaries will explode or sink the Bell System. We don't object to subsidiaries per se.

Let me just suggest that there are three conditions we would like to see with respect to subsidiaries.

First, we ought not have any unnecessary ones.

Second, we need to make sure that the subsidiaries, once created, are financially viable and legally viable.

Part of the point Mr. Schnee made about the fact that we don't yet have financial models of what these would look like once set up is a valid point.

We would need to look at that.

Third, once we have these subsidiaries, we must be able to work with them. In other words, subsidiaries must be controllable by the parent and there needs to be the possibility of reasonable interaction between the affiliates. What I am suggesting, Mr. Chairman, is that once we understand the full implications of the legislation when it becomes law, that you give the management a chance to exercise its judgment on the precise nature of the subsidiaries we would be required to set up.

I simply would represent, I think, that there has been perhaps a misunderstanding. We don't object to the setting up of additional subsidiaries per se provided they make sense.

Senator HOLLINGS. Provided they are at arm's length. Let's talk about that for a second.

When you say make sense, and dealing at arm's length, you have an entirely different cost accounting system for the wholly owned subsidiary as I envision it.

Is that the way you do, also?

Mr. GOLDSTEIN. I would assume each subsidiary would have its own accounting system.

Senator HOLLINGS. We could identify the cost. We might never solve the total cost allocations of the mammoth A.T. & T. but we could say if you went into competition with Mr. Harcharik and these other organizations, we can see that subsidiary and find out its cost and capital and financing and operation's expenses, where they came from and how to allocate it, so we can see whether the monopolistic power of A.T. & T. was being unfairly employed in order to compete with him, is that correct?

Mr. GOLDSTEIN. Mr. Chairman, there is one problem.

I think certainly most of the things you said would be correct. You could certainly separate a lot of the costs if you had a separate subsidiary. There is one area where it remains a difficulty that still requires accounting systems and still requires some allocational rules.

That has to do with the joint use of facilities. What I mean by that is that if a particular microwave system, for example, has in it circuits that serve both a monopoly and competitive service, one still needs to account for the costs of that system and needs to separate these costs and allocate them equitably in some way to service one and service two, so that the setting up of the subsidiary does not obviate the need for an accounting system and the allocational rules.

Senator HOLLINGS. Senator Cannon?

The CHAIRMAN. Thank you, Mr. Chairman.

Mr. Schnee, I was interested in your comments about the subsidy that A.T. & T. is getting now.

You say that since 1969, the company received return-free about \$11 billion of subsidies. Elaborate on that a bit, will you?

Mr. SCHNEE. Certainly.

First, regarding the terminology, this is money that the company has the use of return-free. No interest paid on it. No dividends. No dispute about that point.

The way it came about was through two provisions in the tax law which went through in the 1969 and 1971 tax revisions, and there was very little discussion of these provisions.

There were a few witnesses who appeared. I might add in the 1969 legislation the Chief of the Common Carrier Bureau of the FCC made a statement criticizing the depreciation provisions. Essentially, what is involved here are tax benefits, the use of deferred taxes for tax purposes using accelerated depreciation, thereby giving you a lower tax than if you used your normal straight line for a straight-line company, and the use of investment tax credits.

Every company has the right to use those tax benefits. There is no dispute about that. There is no dispute about the policy of allowing companies to use the tax benefits.

What the legislation provided in effect was that when A.T. & T. got the tax break and didn't pay as much taxes because it used accelerated depreciation and didn't pay as much taxes because of the investment tax credit, it still continued collecting those taxes from the ratepayers as if they had to be paid. This was provided by the law and the distinction here is that any other company that uses a tax break, whether it's an investment tax credit or accelerated depreciation and doesn't pay the taxes, doesn't have a legal right to charge its customers as if it were paying those taxes.

If it's in a competitive business, it certainly, if all its competitors are getting tax breaks and lowering their prices, it wouldn't be able to charge its customers as if it were still paying the taxes.

Now, the result of all this is that the whole theory of public utilities in this country, and all the textbooks agree on this, is based on the assumption that the regulators are going to make the utility behave as much like a competitive company as possible.

They are supposed to instill the incentives they don't get because they are monopolies. What we have done here is, I think, very unwittingly on the Congress' part because I don't think there was any real discussion of this when these very large tax bills were being considered, but what we have done here is we have defied the competitive model.

In the competitive situation, you simply couldn't be charging your customer for taxes you were no longer collecting and, in fact, we saw an example of this when the Bell system itself had to go out and sell PBX's on a competitive basis.

The question came up what do they do when they are pricing this individual product?

We found a case in Massachusetts where the record was established clearly and the Massachusetts Commission stated in writing their opinion: What the Bell system did was price the thing as if their taxes had been reduced, as they were, and didn't try to charge the PBX customer for this tax saving.

They passed it on as a reduction in prices.

The CHAIRMAN. What you are really saying is that that form of subsidy found itself into the competitive activities of the company in an unfair competition way against other competitors.

Mr. SCHNEE. What I am saying is on the competitive side where they had an incentive to try to cut their price to meet competition, they acted like a competitive company.

On the other hand, they loaded it on to the monopoly ratepayer, that ratepayer has to keep paying these taxes because they are built into the company's rate structure and into the bills.

Some of the State regulators, incidentally, have been trying to figure out ways to avoid the impact of this legislation.

The only one that apparently has succeeded is California. But I think the method used in California is not to be preferred to actually rethinking this whole policy of how these subsidies came about and the impact on competition and the capital market in this industry.

The CHAIRMAN. Do you see anything in this legislation that would stop a parent company from continually, let's say, lending money to prop up a competitive subsidiary which is underpricing its product and losing money?

Mr. SCHNEE. As legislation stands now, I don't see it.

The CHAIRMAN. Do you think that is a problem?

Mr. SCHNEE. Yes, I think it's a very serious problem because A.T. & T. is so large. If it were a smaller company, if it went on for a few years, I am sure it would become apparent to the financial community that this was financially an unhealthy venture and there might be some check on it.

But I feel with A.T. & T., the numbers we are talking about here are so large, and also this entity might be so complex, they might be doing it in selective areas and you could see a good deal of competition wiped out.

I am sure in areas such as Mr. Harcharik was talking about, if they came on with ACS and wanted to do that kind of exercise, they could do it for a number of years and you could see competition wiped out in a number of areas.

In the final results, you would have a difficult time identifying what was going on.

The CHAIRMAN. What, if anything, do you think we can do about that?

Mr. SCHNEE. As the legislation now stands, I am very hard-pressed to offer you an easy solution.

One of the things I intended by suggesting that a financial model would be helpful was not to get off into an endless exercise. I think some preliminary model is the way to put it.

If we looked at where the money was coming from, how big this entity might be, what the areas were where there might be—and how cross-subsidization might occur, by breaking out the activities of this entity very carefully, we might come up with some suggestions.

At the present time, it's a very difficult problem, because this legislation stops short of divestiture and the dividing line really as I see it between divestiture and what you have done here is that the parent company puts up the equity money.

That is the right that you have given the company. I think that trying to put limitations on that, such as by later regulation, the Bell system would complain you have left us this right under the legislation.

That is what we understand the legislation to mean.

I don't think there are restraints that exist that will help you out on that. I think you are left to their judgment as the legislation stands.

That is the dividing line between divestiture and separated entities, that purse string.

The CHAIRMAN. Mr. Goldstein, as I understand the existing Communications Act, you can continue to offer a service which has been declared unlawful until such time as a lawful tariff is settled on by the Commission, is that correct?

Mr. GOLDSTEIN. With some exceptions, I believe that's true. I am not the expert on this.

The CHAIRMAN. Then if that is given, in your statement you say and I quote: "We obviously have an incentive to get these tariffs approved so we can get on with the business of offering service to our customers."

It seems to me there isn't any real incentive there if you could continue to offer that service and take tariff.

For example, how many years did A.T. & T. offer Telpac services at rates which the Commission determined to be unlawful?

Mr. GOLDSTEIN. I don't know the answer.

The CHAIRMAN. Would you supply that for the record?

Mr. GOLDSTEIN. Surely.

[The following information was subsequently received for the record:]

TELPAC RATES

During the hearings on May 2, 1979, Edward Goldstein, Assistant Financial Officer of AT&T, agreed to supply for the record a response to the question, "How many years did AT&T offer TELPAK services at rates which the Commission determined to be unlawful?"

TELPAC has not been offered at rates which the Commission has determined to be unlawful.

Soon after the TELPAK offering was made in the early 1960s, the FCC instituted an investigation of the lawfulness of the TELPAK rates (Docket No. 14251) and in a series of orders found that TELPAK was a "like" communications service with other private line services which were not obtainable at bulk rates. The Commission held that the rate differentials established for the former TELPAK A and B classifications (12 and 24 voice channels) could not be justified in terms of cost or competitive necessity and should be eliminated. With respect to the TELPAK C and D classifications (60 and 240 voice channels), the Commission concluded that these rates were justified by competitive necessity but that further investigation was required to determine whether these rates were compensatory, i.e., whether they would bear their own costs or would be a burden on other customers of the company. 38 F.C.C. 370 (1964), 37 F.C.C. 1111, 1117-1118 (1964), 38 F.C.C. 761 (1965), *aff'd sub nom. American Trucking Ass'ns v. FCC*, 126 U.S. App. D.C. 236, 377 F.2d 121 (1966), *cert. denied*, 386 U.S. 943 (1967). Following judicial affirmation of the Commission's decision, TELPAK A and B were eliminated.

Following this Court's affirmation, the commission incorporated the remaining TELPAK issues into Docket No. 16258, which was later consolidated with Docket No. 18128. The FCC's first Order in Docket No. 18128, released October 1, 1976, 61 F.C.C. 2d 587 at 657-59, had ordered that TELPAK be eliminated by June 8, 1977, because the rate differentials embodied in TELPAK C and D purportedly were not justified on the grounds of competitive necessity. However, in an order adopted June 6, 1977, the FCC revoked its previous order that TELPAK be eliminated by June 8, and concluded it had failed to give adequate notice of certain issues, including competitive necessity.

Contemporaneously with these developments, in Docket No. 20097 regarding the broad issues of whether resale and sharing of telecommunications service should be required, the FCC found that unlimited sharing and resale of private line services, including TELPAK, was appropriate. 60 F.C.C. 2d 261 (1976), *reconsid.* 62 F.C.C. 2d 588 (1977), *aff'd, AT&T v. FCC*, 572 F.2d 17 (2d Cir. 1978), *cert. denied*, 47 U.S.L.W. 3225 (Oct. 3, 1978). AT&T had previously indicated that a requirement of resale and unlimited sharing would destroy the economic validity of TELPAK; accordingly tariff revisions were filed in March 1977 providing for the elimination of TELPAK upon the effectiveness of resale and sharing and, by order adopted June 2, 1977, the FCC denied petitions to suspend or reject. 64 F.C.C. 2d 959. The Department of Justice and others had filed judicial appeals to prevent AT&T's voluntary withdrawal of TELPAK and such withdrawal has been temporarily stayed by the United States Court of Appeals for the District of Columbia over the objection of the FCC. On July 21, 1977, over the objection of the FCC, the D.C. Circuit ordered that AT&T be enjoined from discontinuing TELPAK to customers served and under the terms and conditions then existing (i.e., pre resale and sharing which became effective on July 22, 1977). The TELPAK cases (No. 77-1333 *et al.*) were argued before the Court on February 27, 1979.

The CHAIRMAN. Isn't that a disincentive rather than an incentive? If you can continue to charge rates, like we heard here now, the numerous rates that have been held and determined to be unlawful, and yet you are continuing to charge them because no lawful rate has been approved.

Mr. GOLDSTEIN. Senator, the question of lawful rates of course, turns often around this very thing that I had discussed earlier, namely disagreements on the costing methodology that is to be used.

The problem with rates that have been declared unlawful to us is that they raise the rather considerable uncertainty in everybody's mind, since we obviously will have to change these rates, so the incentive we have is to remove that cloud from over these tariffs.

Of course, with respect to new tariffs, the Commission has no requirement to allow these rates to go into effect. So again, the incentive is to get these tariffs into effect.

I wonder if I might comment on the tax matters that you and Mr. Schnee have been discussing.

The CHAIRMAN. Sure.

Mr. GOLDSTEIN. To begin with, I believe there was rather considerable discussion when this tax legislation was passed about the issue of flowthrough, which is what Mr. Schnee is talking about.

Namely, whether these tax benefits should be flowing through to the customer in the form of immediate rate reduction. With respect to the accelerated depreciation, of course, this is a tax reduction, but in the long run we still owe these taxes to the Government.

With respect to the investment tax credit, the purpose of that was to give an incentive to ourselves as well as to others who benefit from this to invest this money in new facilities.

Of course, if that were flowing through to the customers, that money would not be there. With respect to the tariff in Massachusetts, I am not too familiar with that particular matter, but I believe that our rates, whether they be for competitive services or otherwise, don't flow through the tax benefit either for competitive or monopoly services.

As for your question as to how—the point Mr. Schnee made about the parent being able to subsidize in effect a subsidiary, presumably what we are concerned about here is that the parent or whatever the affiliate is that offers monopoly services would be able to cross-subsidize the competitive services.

We think there ought to be a safeguard against that. I would simply remind you that the monopoly services will continue to be regulated and presumably the regulators will have the right to make sure that we don't cross-subsidize from these services.

The CHAIRMAN. My 10 minutes are up, but if the Chairman will permit me, I would like to give you the opportunity to respond to that if you care to.

Mr. SCHNEE. Well, about the tax benefit issue, Mr. Goldstein made three points.

One was on the amount of discussion had at the time. We went back to the records of the legislation and you will find those bills, as I am sure you will recall, contained quite a number of other provisions that got quite a bit of attention but I don't think this issue of the treatment of tax benefits by utilities got very much.

On the record, the number of statements made on it were quite few. I think on the investment tax credit flowthrough, it may have been as little as two statements in the record.

A number of the statements made were quite perfunctory. There was no real debate. When you consider the amount of money involved here, this is a \$2.2 billion a year subsidy to A.T. & T., alone.

The kind of debate we had on issues such as extending loan guarantees to Lockheed Corp. or the city of New York, where the gross dollars are really not a fraction of what is involved here, I think the amount of discussion was extremely light.

Second, I think that this idea of the investment tax credit being meant to provide an incentive, I think that is likely to get confused.

What we are talking about here is not the effect of the tax laws. Nobody is disputing that these tax benefits are available. What we are talking about here is what happens when a company prices its product? Does it charge its customer as if it didn't have an investment tax credit?

The fact is that in a competitive environment, I don't see and I don't think anybody came up with a way that the company can price its product as if its tax rate were higher because its competitors are getting the same tax benefits and price their product accordingly.

It will be underpriced in the market. There is confusion about when you cut taxes—we had a lot of discussion about that in the country in the last year, about the effect of cutting taxes—and a tax cut is designed to spur business by lowering the level of taxes it pays.

Now, suppose, if somebody proposed to you that the taxes on corporate income were entirely cut out and said to you: "Will that spur business?" We would say: "Yes, it has to."

But what Mr. Goldstein is saying with the A.T. & T. position is that: "No, that isn't what spurs business. It's when you allow us, after we have stopped paying taxes, to keep collecting that money from our customers in our prices."

I don't think there is logic to that position. Furthermore, in the context of the *Massachusetts* case, since Mr. Goldstein brought up the point that A.T. & T. does not flow through in their competitive pricing, I would like to read one sentence from the opinion of the Massachusetts Public Service Commission which stated in regard to the pricing of PBX's: "For the purpose of determining the costs of providing a competitive service, New England Telephone has reversed this historic position and in effect proposes direct flow through of tax benefits."

The CHAIRMAN. Just one comment.

You might think about this and talk about this a little later because my time is up, but it would seem to me on the investment tax credit, if they are using that for a real true investment, this is saving them from going out on the open market and acquiring funds to create that investment with.

If they do that, that certainly is a proper part of the rate base.

My time is more than up. Just think about that a little. That disturbed me.

Thank you.

Senator HOLLINGS. Thank you.

Senator GOLDWATER.

Senator GOLDWATER. Yes, Mr. Chairman.

The purpose of this legislation is to provide the best service to the customer.

Frankly, I believe the proponents are thinking in that direction, the main thrust of their argument seems to be cut down A.T. & T.

We hear a lot about fair competition. We hear that A.T. & T. long lines should be established as a separate entity.

I would like to suggest, Mr. Chairman, that these people who are opposed to A.T. & T. prepare a model we can look at.

Frankly, this chart doesn't show me anything.

We are trying our best to make head or tail out of a system that is largely Greek to most of us.

I would like to see the opponents of A.T. & T. or any other company that seems to be in a dominant antitrust position prepare a model of what the system would look like.

We have the best telephone system in the world. It was brought about by a large number of small telephone companies working together with one big telephone company.

Our rates go down year after year. Profits seem to stay up. The question in my mind, Mr. Chairman, is if we break up A.T. & T. as is being suggested, do we wind up with better or worse telephone service?

There is a strong tendency in this country—unfortunately, I believe—to criticize bigness. While I don't propose for 1 minute to protect unwarranted domination of an industry, until something better can be suggested, I will have to go along with it.

I would like to begin to see some models presented to us on what would happen.

For example, how are we going to break up the A.T. & T. switching system? There is no way that I can think of that more than one company could handle this.

More than one company might participate in its management, participate in its profits, but I don't know if that would make it better or worse.

I have a question for Mr. Goldstein.

Last week I asked your chairman how enactment of the provisions of S. 611 requiring fully separate subsidiaries would affect the ability of A.T. & T. and its operating companies to fulfill their obligations to bondholders.

I didn't get much of an answer. Do you have one?

Mr. GOLDSTEIN. I referred to that very briefly when I commented on that chart. We believe that in order—if we were to set up a subsidiary, that there would be some considerable difficulty in setting up some national subsidiary such as the one that has been depicted on this chart.

We need to have the present telephone companies, the issuer of these bonds, in some instances, at least, be the owner of that same business.

You can't just transfer property back and forth willy-nilly. I believe there is a paper being prepared, Senator Goldwater, to answer that more specifically, but there is in fact deep concern to

us with respect to these bondholders if we were to start transferring property around.

Senator GOLDWATER. I was told after last week's hearing that you are proceeding in an assiduous way to develop an auditing system.

Are you really doing that?

Mr. GOLDSTEIN. Yes, sir. We have spent about \$400 million so far since 1973. We are probably about half way through.

Right now, the main activity there is the revision of the uniform system of accounts. As you know, the FCC promulgated a notice of proposed rulemaking last July. We responded to that.

Incidentally, I might say that we don't object to the disaggregation of our costs that has been required by the USOA notice.

We have told the FCC we would disaggregate our cost. We do have some problems with the particular method they have suggested, but we have no objection to the kind of disaggregation they are talking about. We are proceeding on it.

We hope to hear from the FCC with some preliminary decisions at least this summer.

Chairman Ferris said there would be information. We don't know when we will get a final order from the FCC on that or what it will say, but we are working assiduously on doing the work that is necessary for any kind of accounting system regardless of how that order will finally come out from the FCC.

Senator GOLDWATER. What is the present bonded indebtedness of A.T. & T?

Mr. GOLDSTEIN. I guess it's a little less than half of the capital structure. It must have been around \$50 billion.

Senator GOLDWATER. Fifty?

Mr. GOLDSTEIN. \$50 billion, yes, sir, something like that. Give or take a few billion.

Senator GOLDWATER. What are your present financing arrangements?

Mr. GOLDSTEIN. I am not sure I understand that question.

Senator GOLDWATER. What are your present financing arrangements? Can you give us a quick guess as to how you go about acquiring \$50 billion?

Mr. GOLDSTEIN. As I say, our debt ratio is something less than 50 percent. We finance basically from three sources. Equity, debt, and then internal financing, a good deal of which is the tax issues that Mr. Schnee talked about, plus, of course, retained earnings.

We go to the bond market fairly often. Generally a couple of hundred million dollars at a time.

Mostly the bond market we take advantage of is through our subsidiaries. That is, through the operating telephone companies rather than the parent. It's the parent that offers equity that is necessary.

I am not sure I answered your question properly but I will be glad to furnish more information.

Senator GOLDWATER. How would these arrangements be changed, if the legislation required fully separate subsidiaries?

Mr. GOLDSTEIN. I am not sure I know. That would depend on just what the legislation said.

If they are truly subsidiaries of A.T. & T., I assume we could continue to finance more or less in the same way that we are financing now. But clearly there is some uncertainty at the moment as to just what this legislation will say.

Senator GOLDWATER. Do any of the rest of you disagree with that?

That is the way I read the legislation.

I think you gentlemen can understand our problem. When we are looking at a company that has bonded debt of about \$50 billion, and that is half their worth, that is a big company. Now it's easy for the average American and the average Member of Congress, who only associates money like that with the Federal Government, to see in that operation a dominance approaching complete.

I am not saying at this moment that I believe A.T. & T. does dominate, or dominates to the point that it harms service.

I think you provide a great service. Not just you, but all people in this particular branch of the communications business. But I would close, Mr. Chairman, by suggesting that these witnesses and others, if they feel inclined, get their heads together and come up with something that they can present to us that can guide our deliberations on a Communications Act that unfortunately has to contain some reference to size.

I am at a loss right now to picture in my mind a model and I don't understand why some small companies would want to break away from this system. I am not the least bit convinced that breaking up A.T. & T.'s long lines will cause rates to come down, but my mind is open.

If any of these witnesses want to come back at any time of the day or night and present us with arguments relating to the writing of this bill, I would certainly like to hear them, because it has become obvious to me that the general thrust in this small part of the total communications picture is to cut down A.T. & T.

That is all I have.

Senator HOLLINGS. Let me say a word before I yield to Senator Exon.

For one thing, we have given incentives to develop expertise in this accounting field. We do it with the Department of Defense. A distinguished Senator told me the average stay of the Secretary in the Defense Department was only about 11 months, if run by the Civil Service, and we were all looking at Defense and the budget in a different light.

When the institution put in the mission control approach, we found out the armed services is following that same approach, and so is the Appropriations Committee, so Congress is beginning to look at what is the mission to be accomplished and how much money is to be allocated.

California gets a lump sum for personnel and equipment and operations and maintenance and that sort of thing.

We began to develop some awareness—not necessarily expertise—about the mammoth problems involved there with A.T. & T. as to how you allocate all these things. It's a real problem. I know one school of thought says you have complete divestiture and that is what we will do in this bill.

I don't think we will get that through the Congress. But various groups are saying we are not an antitrust group. The Senator from Arizona and others asked, and we will have the Attorney General come up, and I don't think we are an antitrust group that will foster immunity. One group would like us to have divestiture and another would like us to grant immunity. I don't think either one will get through the national Congress.

I am back to my real question of an important panel of this kind: Can you really intelligently legislate without divestiture or without immunity and move on realistically to confront the developing field of competition and computerization in communications without destroying the fundamental service on the one hand and being fair to all these folks who are out there that are competing without causing further bankruptcies, and what have you, through noncompetitive practices?

I don't know that we can. We are making an honest try. We are not out to get A.T. & T. But we are not out to be snookered by them either.

We will have to do our level best.

Senator EXON.

Senator EXON. To follow up, basically, what Senator Goldwater said and what the chairman said, gentlemen, we find ourselves up here—specially myself as a new member of the committee—like an umpire between two competing teams, it seems to me.

Generally speaking, my philosophy has been that I am not against bigness as such. If we had the ideal situation, I suspect, we would allow companies to grow and develop as they see fit and maybe have only the antitrust laws to make sure that there is not total monopoly control. I guess the first question I would like to ask is probably of you, Mr. Goldstein, because I suspect the other three witnesses we heard this morning are indeed in favor of some kind of change in the law, but what about you? Is the position of A.T. & T. that we should not tamper with the present act we have on the books?

Mr. GOLDSTEIN. No; that is not our position. Our position is that clarification of these issues is needed, and it's needed through legislation from the Congress, which is really the only agency that can express policy of the people.

Senator EXON. I asked a similar question of your superior, when he testified before the committee, I think, last week—

Mr. GOLDSTEIN. I hope I didn't disagree with him.

Senator EXON. I didn't ask that question. I was warning you of the question I am about to ask.

What communications, discussion, understanding or attempts at understanding have been made between A.T. & T. and the—in other words, the mother—and the kid, adopted, illegitimate or otherwise, that are in this business?

What discussion goes on between A.T. & T. and the smaller companies that are involved in the overall communications business? Do you sit down and talk or try to work out your problems?

Following what was suggested by several members of the committee this morning, if you people could get together and be of help to us, then we could be more effective as umpires.

Mr. GOLDSTEIN. Are you referring specifically to discussions regarding this legislation, sir?

Senator EXON. Yes, specifically about this legislation. Have you attempted meeting with the other companies to come to some general agreement among the conflicting parties?

Mr. GOLDSTEIN. I have not been part of any such agreement, but I believe there does exist a coordinating council of the industry that includes A.T. & T., as well as the independent telephone companies, and I believe that they have held considerable discussions on this subject.

As I say, I have not been party to that.

Senator EXON. If they held these meetings, is there anything they agree on and possibly, after you answer that question, is there anything they agree on, maybe the other members of the panel would comment?

Mr. GOLDSTEIN. There are a number of things they agree on. Indeed, in the preliminary hearings last fall in the House, Senator, I believe that there were several witnesses on behalf of the industry who submitted some documents on the problem as they saw it then. I think there has probably been some movement since then.

Yes, I believe there are a number of things they agree on, and I wouldn't be surprised if there were a number of things they didn't agree on.

As I say, I have not been a party to this, but I am sure someone could tell you about those discussions, if you would like.

Senator EXON. Are those discussions continuing during the Senate deliberations on this bill and counterparts in the House?

Mr. GOLDSTEIN. I wouldn't be surprised, but I don't have direct knowledge.

Senator EXON. Would you gentlemen care to comment?

Mr. GRANT. There have been, of course, some outputs from the industry on this matter in the form of recommendations to Congress.

Just look over the past few years on this matter, there is what we fondly call the Bell bill. That was a recommendation. That recommendation would put us out of business. Then there was the dilemma in telecommunications. That was an industry committee formed. We weren't invited, but it was an industry committee of the established telephone companies.

They did a lot of hard work on that, I am satisfied of that.

And that one would have put us out of business. So from the standpoint of: Has there been some consideration on the part of the telephone industry? Yes, I believe that question can be answered rather positively.

And I think it's the output of the industry plus the results that have been coming out of the marketplace that have brought this bill to the point where it is today. It's not a divestiture. It's, in my personal opinion, a very practical approach to the solution of a very difficult problem.

It isn't all we would like. We would prefer divestiture as a solution. On the other side of the offense, we believe the bill is a practical bill that takes a step that if it works, that is enough.

If it doesn't work, maybe divestiture is the only answer. So we look on it as a practical, workable step of setting up subsidiaries

which in themselves must be independent in their management, financing and directors.

Senator EXON. If it doesn't work, we will have to do more?

Mr. GRANT. If it doesn't work, the Congress, as is the case with other industries, is perhaps faced with taking another step.

In our opinion, this is a very practical, workable approach to a knotty problem.

Senator HOLLINGS. Was Mr. Goldstein nodding his head there?

Mr. GOLDSTEIN. Usually, I find a lot to agree about with Mr. Grant. The point I was making here is that, as I understood him to say, that he does not believe that there need be any more drastic steps taken and that you want to look at this in an experimental way. Will this do the job or won't it?

We believe something like the approach in this bill with some of the changes we would suggest and have suggested could very well work.

We believe it will work. If it doesn't work, then you gentlemen obviously have another job to do.

Mr. HARCHARIK. I would like to say that I think the industry council Mr. Goldstein refers to includes all the traditional carriers, but I don't think it includes we folks out there competing, I don't know if we are in that circle. I don't want to infringe upon your time, but I am disturbed that in general you are concluding that we all just want to break up A.T. & T. That is not at all the case.

Roughly 10 years ago, somebody decided they wanted to encourage competition in the communications industry.

Shortly thereafter, there began to be very good results for John Q. Public, as a result of competition.

Services that our company provides are offered roughly at one-fifth the price to users, that A.T. & T. services were offered that solved that same type of problem.

I think our point is without some kind of legislation—again, we think S. 611 comes very close to this—that can protect the competitor from the cross-subsidization, competition can't exist.

I too believe we have a good phone system. Even Mr. Grant probably uses A.T. & T. phones every day. However, we are competing. We are improving areas of the communications industry to the user.

It doesn't take the breaking up of A.T. & T. It simply takes something that will avoid them taking monopoly ratepayer money and subsidizing in an unfair way anticompetitive practices with which we must compete.

So I don't think we should focus on the idea we want to smash up A.T. & T., because it's big.

Senator EXON. That was a lengthy reply to my question, but I understand you wanted to get that in the record. I have no other questions at this time, Mr. Chairman. Thank you.

Senator HOLLINGS. We will leave that record open. I would like the specifics, the specifics of a separate arm's length entity.

Do you think we have adequately addressed the problem in the legislation or not?

Mr. HARCHARIK. You certainly addressed it. There are a few areas in which we would like to see some things strengthened and tightened up.

I am still concerned that it leaves too much to the Commission to decide when a monopoly carrier needs to create a category 1 carrier for competition. There is too much, I feel, that the Commission can decide after hearing that might continue to allow the present circumstances to exist in the future.

So in that regard, we would like to see it made more specific, about the creation of arm's length subsidiaries.

The other thing is——

Senator HOLLINGS. Or perhaps grant them more power. You get a litany of the illegalities of the various rates but nothing has been done.

The Commission itself has not had adequate power, in other words, so that is another thing we would put in the legislation. Seemingly, the Commission made objective studies.

They have led the way to competition.

Mr. HARCHARIK. Yes, sir. That leads me to the second point.

I don't know how you do this but I would like to see more teeth in it. I would like to see something that would prevent things like we were referring to earlier where we can go on for 5 to 7 years with tariffs being declared unlawful by the Commission and in some cases, by courts, and still continue to have these services offered.

There seems to be no penalty for—maybe take all the revenues for something like 7 years and subsidize social security with it or something, I don't know.

But there is no penalty now.

Senator EXON. If you were smart, you would withdraw that statement from the record.

Senator HOLLINGS. Mr. Schnee, seemingly as you see it, you will have to have complete divestiture or do you see this as an interim approach as Mr. Grant has testified where given a try, it could work or do you think from your expertise you will have to have divestiture, it just won't work?

I don't want to improperly characterize. I am trying to get the real thrust of your statement.

Mr. SCHNEE. I would not reject this approach because I think you are doing a number of things in the legislation that could be beneficial.

My concern is that if we just get a rather gigantic entity with a bunch of lines of business, and we have broken off from A.T. & T.'s some-odd billion dollars revenue \$15 billion or something and now we will try to figure out what both of those resulting companies are doing, I don't think you will get the benefits of it that the legislation, I think, anticipates. I think it was drafted with the benefits in mind.

I think there has to be some clear breakdown of each line of business that that entity is doing. I think——

Senator HOLLINGS. What about conditions on a monopoly parent continuing to pour equity money into a loss-making subsidiary?

Can we place conditions in the legislation—it's difficult to categorically write it in black and white in the legislation, particularly when it's either competitive or noncompetitive.

Someone has to make that financing.

Mr. SCHNEE. I haven't found a solution, frankly. I have given it some thought. Perhaps not as much as it deserves yet. But you have a real problem. The way limitations have classically been placed on has been through things like rate of return regulation which is something you absolutely don't want here.

That entity has the right to earn as much as it can as a competitor and trying to regulate its rate of return on the downside might give you a mechanical tool, but I suspect all you would wind up doing is promoting some regulatory exercises that you probably don't want to promote anyway.

I think in terms of any absolute limit on it, it's very difficult to see. Whatever you did would have the degree of artificiality.

For example, if you said to A.T. & T., OK, designate these activities and prescribe how much equity you will put in at the start so this can be self-financing in the future—if it wants to go into another line of business, go through that same activity at the outset.

You get one shot to put equity in and after that, this business goes on as a competitor or not. I am sure that A.T. & T. would object because there are a lot of things you can't foresee at the outset.

I have gone through financing new companies myself on a smaller scale than this.

But nonetheless, I am aware of the practical problems. Finding a formula which actually somehow gives you some way to check on the equity flow is where I think you run into your knottiest problem.

I see suggestions but I don't say they are the answer.

Senator HOLLINGS. What about the bottom line? When you have separate, arm's length subsidiaries, are they workable in the context of the continued good interstate total calling system, long-distance lines?

I can see myself on the Senate floor and they say, "Well, you have done a good job. We appreciate all the hard work. But you can't do it because it will mess up all the long-distance calling. You have to have A.T. & T., one entity, operates all long-distance calls and this arm's length subsidiary sounds good in the classroom but in real life, it won't work."

Do you find it workable?

Mr. SCHNEE. I am not too frightened of that. One of the reasons is when you get down to the real record of accomplishment in this area, I think the company takes credit for a good deal more than they have accomplished.

One of the pieces I wrote noted, and it's interesting to me, that Chairman deButts was up before the House committee and gave a three-paragraph description on what it's like to manage the system and it contained phrases such as "constantly balance and rebalance the capacity of our switching centers and transmission lines * * * take account of changing call patterns * * * the opportunities that new technology affords * * * do it at the lowest cost * * * requires a unified system, requires a unified approach to its management, et cetera.

It happened that shortly before that—this testimony took place in early 1977—the Commission came down with an opinion in

docket 19129, which had gone into the management of the network in great detail. There was a lot of discussions about it in the docket. The FCC found, first of all, there had been persistent overinvestment in the network. It's presently underutilized.

It was underutilized in prior years as well." A high percentage of idle plant during most of the business day. Much excess capacity. A general overbuilding of the interstate total network."

What was even more shocking to me was that in the preliminary opinion of the judge who heard the evidence—an opinion which was almost ill-advisedly favorable to A.T. & T., due to a number of findings the FCC later threw out—but when he came to the issue of the management of this interstate network, what he said was:

It's strange, perhaps bordering on the Kafkaesque, that the Commission has never attempted to examine in depth the engineering of Bell's telephone network.

One is also left in some doubt insofar as the present record is concerned—and it was a very thorough record—whether Bell itself ever conducted a thorough analysis of its own network which for all that appears herein grew by leaps and bounds without a great deal of serious consideration to possible cost savings.

I don't think on the record we have, that I am frightened by trying alternatives in the long-distance system.

Thought must be given to that. The good parts of what long lines accomplished we want to retain but the company has consistently taken much too much credit and painted this as being an achievement which exceeds reality.

Senator HOLLINGS. We have another panel.

Do you have any further questions?

The CHAIRMAN. I think I better defer them.

Senator HOLLINGS. Thank you very much.

Our next panel consists of Mr. Jerripts, Mr. McGowan, Mr. Beere, and Mr. Whitney.

We will start with Mr. Beere.

STATEMENTS OF STEPHEN G. JERRITTS, HONEYWELL INFORMATION SYSTEMS, INC.; WILLIAM G. MCGOWAN, MCI COMMUNICATIONS CORP.; MAX BEERE, TRW; AND L. C. WHITNEY, COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION

Mr. BEERE. Thank you, Mr. Chairman, and members of the subcommittee.

I must preface my remarks by issuing a disclaimer—I am not representing TRW and the positions I am presenting are not necessarily those of TRW.

I'm speaking as an industry observer and as an industry participant. But, as my experience has in part been with TRW, I will rely heavily on that experience using TRW as an example. My remarks then will be based on TRW and companies like TRW, the multinationals.

The companies who find themselves operating in many countries of the world, many States of the Union and cities of all sizes. It's these large companies from which the communications industry derives large portions of its revenue that will be impacted by the efforts of this committee.

These companies, made up of many smaller divisions and smaller companies, are usually widely dispersed geographically, diversified in product line and held together by tight financial controls.

Though my current experience is with larger companies, my remarks are equally applicable to the small business because TRW, like many large companies, is a composite of many small businesses, each of which has a responsibility for its own destiny.

I've taken the time to develop this base so that you might better understand my position. It is within this business/industry environment that communication is so critical.

I believe the work that is being done now to rewrite the Communications Act of 1934 is of pivotal interest. I say pivotal because I believe that the great strides industry will or can make in the near future will be made based on industry's communication knowledge and the freedom to exercise that knowledge.

This translates into higher productivity, lower costs and more jobs. I applaud your efforts toward controlled deregulation of communications and the introduction and fostering of competition which in my estimation will hasten technological advances that will make more communication capability available to more people.

But I have some concerns. I'm concerned that there be full and fair competition and I wonder if this can be guaranteed by the FCC via an appropriate accounting structure as is indicated could be the case for a category II entrant into a competitive market segment.

I believe the fully separated subsidiaries might be a more workable option.

I'm concerned that the FCC is to be given such blanket authorization to establish and enforce requirements with respect to design, manufacture, and maintenance standards for telecommunication equipment and electronic equipment intended for connection with a telecommunication network.

I understand the interest is to merely foster the already existent registration or certification program, but the bill is much broader than that.

I believe the interest and attention of the bill should be at the physical and electrical interface to the telecommunications network only.

I'm concerned that once the FCC has this increased jurisdictional authority over interexchange service and terminal standards, et cetera, it will be sensitive to competitive thrusts that would, according to this revision, argue for deregulation or at least a lessening of regulations.

I look forward, however, to a common pricing structure covering inter- and intrastate service.

I'm concerned over the lack of precise definition of very important gaging terms. I would like to see them more specifically defined. Terms such as: "Media," as in telecommunications media; "market;" "Electronic equipment;" "Telecommunications equipment;" "Terminals;" "Telecommunication service;" "information service;" "Interface standards;" and "Accounting practices."

These bills seem to be written from a position of knowledge of what the telecommunications carriers would like, would need or would not like or need.

But I'm concerned that adequate attention is being given to the needs and interests of the user—from the user's point of view rather than from the vendor's point of view.

Let me explain what I mean by using a TRW example. TRW is, in its electronics division, a manufacturer, seller, and installer of terminal equipment.

In three product areas, point of sale, electronic funds transfer and credit information systems, TRW includes a communication quotient in the equipment we sell.

This quotient exists in the sophisticated terminals of today because advances in technology have made it possible to include logic in the terminals.

The logic elements are composed of small microprocessors and an adequate amount of memory on a few small chips and at a very low cost.

These logic elements expand the capability of the terminals vastly, depending upon the dexterity of the programmer and the availability of understood communication service, because of the terminal's ability to massage information before or after or in conjunction with other terminals or even with dissimilar machines like large-scale computers.

This technology has various names but the one most used is distributed data processing—or it could be termed distributed communication processing.

I believe them to be the same. This capability seems to be covered under what your bill calls information service. My point is that since these devices switch, a basic processor trait, they fall within the bill's jurisdiction—unintentionally, from what I understand but nevertheless there.

And, further, since many such systems appear on customer-provided facilities both on the premises and sometimes interconnecting different premises, it appears that under this bill the FCC must, or could, determine the extent to which the entity is subject to effective competition in the provisions of this integrated service.

The FCC could then decide whether to classify the system as a category I or category II carrier. I do not believe in this case FCC intervention is reasonable.

In order to fully utilize the benefits of decentralization and the efficiencies of centralized support, a highly decentralized organization must make use of communications.

Since increasingly large amounts of data must be circulated among the members of a corporation, a private network soon, in today's world at least, appears to become an economic and expedient necessity. It would also appear that great economies and efficiencies could be gained from such networks by sharing with other customers or even competitors who have like needs.

It appears under this bill that if a company were to develop such a network even though it used carrier facilities, it may be forced to become a category I, or even II, carrier depending upon how the FCC looks at the network switching modes.

Finally, let me bring out another concern not necessarily caused by your bills, but by the evolving situation.

Your bills deal with two very important aspects of telecommunication—deregulation and competition.

May I respectfully suggest that you bear in mind a third equally as important aspect—education. You see, we have for so long depended upon the common carriers to build our communications

systems for us that when given the opportunity now to throw away the carrier crutch and walk relatively unaided we are a little wobbly.

Industry needs time to learn to expand its thinking in the use of communication services. We would like to know that there is enough flexibility in the regulation principles to allow us to expand our communications systems as we learn how to do so.

That incentive inhibiting rules will not be promulgated prior to their effects being fully understood. Up to now, relatively speaking, our involvement in communications was to purchase or lease and supply to the carrier interface devices—black boxes, modems, multiplex controllers, et cetera.

We now find ourselves with this black box mentality in a systems environment. And I don't believe that the majority of us are aware of it or know how to deal with it now, but we shall in time.

We don't need another crutch—we do need a communications environment to deal in that is free of as many use inhibiting factors as possible.

What we require is the freedom to develop systems using communications that are consistent with our evolving technology and business needs.

I believe the revision of the Communications Act of 1934 is badly needed and timely. Let's be sure we are liberated from past structures and keenly aware of the explosive potential of telecommunications.

We are in an age where man's intellect can be expanded by the computer but it's going to be of little value unless the result can be easily transported from where it is obtained to where it is needed.

Thank you.

Senator HOLLINGS. Thank you very much, Mr. Berre.

Mr. Jerritts.

Mr. JERRITTS. Mr. Chairman, members of the subcommittee, my name is Stephen G. Jerritts. I am vice president of Honeywell Information Systems Inc., and I head up Honeywell's computer business in the United States.

I am grateful for the opportunity to appear before you today to contribute to this group's work on what may well turn out to be the single most important piece of legislation of the coming decade affecting the computer industry.

Mr. Chairman, I am here today in a dual capacity. First, I am pleased to submit the written testimony of our industry association, CBEMA, the Computer and Business Equipment Manufacturers Association, on S. 611 and S. 622. As you will note from the CBEMA statement, Mr. Chairman, a wide variety of interests are represented by CBEMA member companies. There are differing views on some of the particular questions raised, and in other cases, definitive judgments may not have been reached. Nevertheless, CBEMA is able to provide its statement as the majority view of CBEMA members concerning the basic issues raised by S. 611 and S. 622.

I personally share and support CBEMA's full accord with the intent of both bills, which is to promote competition and to preempt State regulation of terminal equipment. We are wholeheartedly in favor of those purposes.

I also share with CBEMA the concern it expresses in its written testimony about the sweeping language of S. 611. That language would give the FCC jurisdiction over all commerce in telecommunications and electronics equipment and services, and information software and services. It would extend the FCC's regulatory authority into currently unregulated areas. This is contrary to the declared purpose of the proposed legislation.

I cannot emphasize too strongly the importance of assuring that there be no regulation of the computer industry. In an unregulated environment, the computer industry has exemplified the values of competition. It is an industry with unparalleled growth, technological innovation, diversified services and decreasing prices. The specter of regulation which could result from unclear statutory language, would inhibit the dynamic performance of this industry.

CBEMA stresses that the present language of the bills may undercut their intent and purpose, and suggests explicit language to clear up potential problem areas.

I am sure none of us here, Mr. Chairman, would want to see a relitigation of issues already resolved, such as the customer's right of interconnection.

Now, Mr. Chairman, speaking as a senior executive in the computer industry, with many years of international and domestic experience, I would like to focus the attention of this committee on three specific areas of concern. My comments are intended to assure that the legislative intent of the bills is achieved. This is, after all, why we are all here.

My basic message is that our industry welcomes competition. Indeed, it thrives on it. But only as long as all the competitors play by the same rules.

Simply stated, the three areas of concern are: First, regulation of data processing services, facilities and equipment. There should be none. None is needed.

Second is the subject of maximum separation and cross-subsidization of regulated and unregulated activities of carriers. This subject must be dealt with thoughtfully, thoroughly and explicitly—without ambiguities—in the proposed legislation.

My third concern is a matter of definition: The issue of what constitutes a regulated carrier service and what constitutes a competitive unregulated service is, I believe, a major problem, and should be legislatively defined.

Within my allotted time, I want to deal with each of these concerns in slightly more detail.

First, "no regulation"—as I said, Mr. Chairman, we wholeheartedly support this subcommittee's intention to achieve full and fair competition, and enthusiastically applaud its efforts to preempt State regulation of terminal equipment.

In an unregulated environment, the computer industry has exemplified free competition in action. The price performance of our products has doubled approximately every 4 years. The trend of our industry, because of competitive pressures, is totally counterinflationary. We produce products that do more and sell them for ever-lower prices. Also because of competitive pressures, our technology is advancing at a dramatic rate. And still in this unregulat-

ed environment, our industry annually produces about \$2.8 billion favorable balance of trade.

Therefore, in the interest of preserving free competition in the computer marketplace, we submit that the present wording of certain sections of S. 611 could lead to unintended results in that the jurisdiction of the FCC could be extended into areas beyond its current sphere. This, as I understand it, is the opposite of what you are trying to achieve—that is to diminish, not increase, Federal regulation—an objective whose achievement is eminently worthy of this subcommittee. As I have noted, the CBEMA statement contains specific recommendations in this regard.

Let me now turn to the subject of separating regulated and unregulated activities of monopoly carriers. And, in doing so, Mr. Chairman, I would like to speak first for the Honeywell position.

Honeywell fully endorses the basic intention to separate competitive and tariffed carrier activities. My company, in fact, believes there should be maximum separation between the two, meaning fully separate subsidiaries. In our view, separation is a prerequisite of competition, because it is the only way of effectively preventing cross-subsidization.

In Honeywell's view, maximum separation should mean:

There should be no common directors, officers, employees, financial structure or facilities.

Services and equipment from dominant carriers should be made available to everyone at the same price and under the same set of terms and conditions.

There should be no shared research and development, no shared product facilities, marketing programs nor marketing data.

Dominant carriers—and I emphasize “dominant”—should be precluded from majority ownership of subsidiaries. They should be limited to minority positions.

Additionally, maximum separation should be buttressed by an approved set of accounting and audit procedures in conjunction with the establishment of any nonregulatory subsidiary.

In other words, we believe in free competition—but, as I stated earlier, all competitors should play by the same rules.

To achieve this maximum separation, it is imperative that we have explicit legislative guidance.

Finally, neither of the bills clearly distinguishes between what may be offered as regulated service, and what must be offered by unregulated entities. Basically, the problem of distinguishing between regulated and unregulated services is still with us. More specific language is needed to assure that the regulatory issues of the past years are not relitigated.

Turning to CBEMA, let me emphasize that the majority CBEMA view also underscores the importance of full separation. However, in the CBEMA written testimony, the CBEMA majority position as to particular items that would be encompassed by the full separation concept is stated in more general terms than I have just used, and does not refer to some of the areas I have noted.

Thank you for the opportunity to participate in your hearing today. We are prepared and would be happy to work with the subcommittee to resolve these issues.

[The statement follows:]

**STATEMENT OF STEPHEN JERRITTS ON BEHALF OF THE COMPUTER & BUSINESS
EQUIPMENT MANUFACTURERS ASSOCIATION**

Mr. Chairman and Members of the Subcommittee, my name is Stephen Jerritts, I am a Vice-President of Honeywell Information Systems Inc., a member company of the Computer and Business Equipment Manufacturers Association (CBEMA). I am pleased to submit the following testimony for CBEMA on S. 611 and S. 622, the proposed "Communications Act Amendments of 1979" and "Telecommunications Competition and Deregulation Act of 1979," respectively.

CBEMA is an organization whose membership includes both small and large manufacturers of computers, data processing and office equipment. A number of our members also provide information services to the business, industrial, educational and other segments of our society. In the statement today, we use the term "information services" and "information software" to include the variety of services covered by those terms in S. 611 including those services and software frequently subsumed by the term "data processing." Attachment I to the testimony is a listing of our member companies. During 1978, CBEMA members had total industry related revenues in excess of \$40 billion. They directly employ close to a million people and provide jobs, through customer use of our products and services, for several times that number. Our industry shows a favorable balance of international trade of 2.8 billion dollars. Attachment II to the written testimony is a report summarizing some of the pertinent information in that area.

Mr. Chairman, a wide variety of interests are represented by CBEMA member companies. There are differing views on some of the particular questions raised, and in other cases, definitive judgments may not have been reached. Nevertheless, we are able to provide this statement as the majority view of CBEMA members concerning the basic issues raised by S. 611 and S. 622.

Regulatory policies and legislation in the communications field can have a direct and substantial impact on the economic health and growth of the information service and office equipment industries. Recognizing this to be the case, CBEMA has submitted position statements in this regard over the past several years in a number of forums—to this and other Congressional committees, as well as to the FCC and other government agencies. In its submission to this Committee in February of this year, CBEMA reiterated its view that maximum feasible reliance should be placed on competition in the communications field and recommended minimal changes to the present Communications Act.

S. 611 and S. 622 declare a major policy that telecommunications services and equipment be provided under conditions of full and fair competition, to the maximum extent feasible. The embodiment of this Congressional directive in the FCC's basic charter is an important legislative affirmation of the efforts in recent years to introduce substantial competition in the provision of communications services and equipment. S. 622 proceeds upon the same basic policy. CBEMA commends the authors and sponsors of both bills for building their proposals on this premise, and for recognizing that regulation can be tailored to allow and promote competition as it develops in various communications submarkets, while safeguarding the provision of essentially non-competitive services at fair and reasonable rates.

CBEMA's comments today, the product of a committee effort, are presented from a full appreciation of the difficulties of balancing conflicting viewpoints and interests and of drafting statutory language. Both of the Bills before us show a similar balancing process, as well as the effort to frame new statutory language that is sufficiently clear and precise to insure that the authors intent is carried out. It is well recognized that in an extensive revision of a major statute, there is a risk of overruling important past policy decisions, either inadvertently or by new language which is open to ambiguity or interpretations in conflict with the prior law. For this reason, CBEMA members strongly favor that any new statute be limited to the points at which Congressional intervention or guidance are most needed. Of the two bills before us, S. 622 follows this model more closely, and it would be the preference of many CBEMA members from a drafting point of view.

Addressing the more comprehensive amendments of S. 611 initially, CBEMA's principal concerns with respect to S. 611 relate to the sweeping jurisdiction given the FCC over information services, software and electronic equipment, and to the possible extension of regulatory burdens and constraints into the hitherto unregulated information service and equipment industries. We do not believe this extension of regulation was intended, or that it is in the public interest. However, the point is so basic that there is need for revision and clarification in S. 611 to assure guarantees of non-regulation in these areas. We will address these matters more fully in a moment.

We also want to discuss the need for more explicit assurance that consumers may interconnect equipment of their choosing with carrier services, and obtain similar

connections for privately owned communications systems and facilities, so long as no technical harm is done to carrier facilities. And finally CBEMA urges fine-tuning of the statutory language and definitions in several areas.

Our discussion turns first to the jurisdictional area.

I. JURISDICTIONAL CONSIDERATIONS

A. *Extension of federal regulatory jurisdiction to business activities heretofore unregulated*

As CBEMA sees it, the essential purpose of this legislation should be to reduce the scope of regulation over business activities—not to bring currently unregulated business activities under the regulatory blanket. As we read its “jurisdictional” language, however, S. 611 broadens the scope of federal regulatory jurisdiction in both the equipment and services areas, while it narrows the scope of possible state regulation.

We look with apprehension and surprise upon the provisions of Section 102 of S. 611 which directs that—

“ . . . the Commission shall exercise jurisdiction with respect to . . . all commerce in telecommunications and electronics equipment and services, information software, and information services.”

In terms of jurisdictional reach, it seems clear that this provision confers a basic Federal regulatory jurisdiction over important areas which have heretofore not been considered subject to regulation and which best serve the public on an unregulated basis, as has been widely recognized.

CBEMA believes most strongly that new legislation should not encompass areas of viable, competitive economic activity which have to date been unregulated. This proposal to extend the jurisdiction of the FCC is inconsistent with the declared purpose and intent of S. 611 and is clearly inconsistent with the prevailing trend toward deregulation. The information service and software industries as well as the provision of electronics equipment, have always been characterized by a competitive unregulated marketplace and have experienced a remarkable development and technological innovation on that basis. Since the landmark *Carterfone* case this has also been true of telecommunications equipment. There is no overriding reason, CBEMA believes, to expand the current jurisdictional reach of the FCC.

It is our understanding that one major purpose of the Bill is to obviate regulation of information services and electronics equipment as such by state governments. Such an approach recognizes the national policy that such services and equipment offerings should be provided in an unregulated, competitive marketplace. And to the extent the Bill seeks to assure that varying and conflicting state regulation does not undercut that national policy, we are in agreement with the drafters' objective.

At the federal level, we believe the bill intends that information services industries be free of regulation. Similarly, in the case of electronics and telecommunications equipment, federal regulation would be limited only to those matters involving the requirements for the interface of equipment with the telephone network to the extent—but only to the extent—that this may be necessary to protect the technical integrity of that network. We are in full agreement with that objective as well.

Our concern is that the broad statement of jurisdiction in the Bill could, despite present intentions, be construed to permit regulation in these areas. We believe that the Bill's objective can be achieved without expanding the jurisdiction of the FCC. One solution would be to include a statement in the Bill that national policy is not to extend either State or Federal regulation to information services, electronics equipment and telecommunications equipment, except to the limited extent necessary to permit the FCC to specify technical interface criteria.

B. *Potential extension of regulation to equipment*

In the area of telecommunications and electronics equipment, the reach of regulation could be expansive under the present wording of the Bill. The avoidance of litigation and unnecessary future confusion requires modification of the present wording of S. 611.

Section 203(d)(1) of the Bill permits the FCC to establish and enforce such requirements with respect to design, manufacture and maintenance standards “as are necessary . . . to foster competition in the relevant telecommunications equipment, electronics equipment, information software and information services market or markets.” Read literally, this section gives the FCC the power to order changes in the design of computers, to prevent the introduction of new computer models, or to require specific interfaces for data processing equipment, if these actions would plausibly foster competition in the information software or service market. Moreover, with respect to equipment more clearly intended to be covered, the language is broad enough to encompass a wide-ranging control of “design, manufacture, and

maintenance standards" in order to foster competition in the equipment and information services and software fields.

Read together with the authority granted in amended Section 102(a), the Bill could even be construed so broadly as to give the FCC power to set design standards for digital watches, pocket calculators, electronic grocery scales and all manner of consumer devices which employ solid state electronic components. While such a reading of S. 611 seems strained, nonetheless the words clearly permit such construction.

The Section 102(a) award of jurisdiction over "all commerce" in electronics and telecommunications equipment is not necessary to implement the drafters' apparent intent, as expressed in Section 203 (a) and (c), to establish a fully competitive equipment marketplace, subject only to safeguards needed to protect the technical integrity of the telephone network. Such an objective could be met, however, if the Bill were to declare that the provision of equipment used with the telephone network shall not be part of a regulated activity, except in the most limited circumstances of the smallest carriers.

The FCC's role in the equipment marketplace would be confined to assuring that carriers not subject to effective competition may participate in this market only through fully separated entities, and that all equipment attached to the telephone network meets interface standards necessary to prevent technical harm to the network.

These objectives can be accomplished by drafting a new Section 102(c), omitting the "all commerce" clause of Section 102(a), deleting Section 203(c) and (d)(1) entirely and leaving 203(a) intact. Attached to this written statement is the text of Sections 102 and 203 as they would read with these revisions. In line with CBEMA's view that maximum separation is the most feasible means at present of preventing cross-subsidies and assuring a fairly competitive marketplace, our statutory revisions would require this approach as outlined below.

In framing a new Section 102(c), moreover, one further point should be noted. As presently drafted, there is no provision which states explicitly that customers have the right to connect any equipment of their choosing to the telephone network and to Category II carrier services, so long as applicable technical standards are met. This customer right was won after long litigation before the FCC and the Courts, and it should be explicitly included in any revision of the Communications Act. Similarly, the Bill should make explicit that customers have a right to connect duly authorized private communications systems, such as private microwave networks or satellite earth terminals, to local exchange facilities and services of Category II carriers as necessary to achieve the purposes for which the private systems were authorized.

This principle was also established in a body of case law under the 1934 Act, and it should not be inadvertently left out of the new statute.

CBEMA's suggested new Section 102(c) is framed to specifically limit FCC jurisdiction over customer premises equipment used with telecommunications services, and to declare the consumer's right to interconnect private equipment and communications facilities to the services of local exchange and category II carriers.

C. Potential extension of regulation to information services and software

Under S. 611, data processing services and software as they are sold—and have been for many years—could be construed to be carrier offerings, at least in part. While this may not have been intended—and should not be the case—the danger is there. The avoidance of future litigation and confusion requires language modification.

Many vendors of information services have customers at widely dispersed locations throughout the United States and in foreign countries. Because of this pattern of service, data processing offerings are available even in rural areas—i.e., wherever basic telephone service is present. However, the computer and related equipment needed to receive, process and provide for the retrieval of the data may be located in distant central locations. The information service vendor frequently, therefore, leases communications services from common carriers and uses these services in moving data from the point at which it is obtained from the customer to the point at which the processing activity occurs. The same services are used to move retrieved data from the point at which it has been processed and stored back to the point at which it is turned over to the customer.

No separate charge is made to the information service customer for the communications expense involved, but obviously, it is one of the expenses that must be met by the information service vendor. In a broad sense, it is one of the expenses covered by the customer's payment for the information service.

In a similar vein, for example, airline, hotel and automobile reservation systems provide access to their computer capabilities—usually through WATS lines—to

accommodate the public need for reservations. Here again, the communications expenses must be covered by the charges to customers for airline, hotel, or automobile accommodations.

A reasonable reading of the working in S. 611 would say that information services such as those described do not involve the offer of a telecommunications service "for hire". But a "telecommunications service" is broadly defined in Section 103 of S. 611 as "the offering for hire of a telecommunications capability under any terms and conditions". "Telecommunications" is defined in Section 104 of S. 611 as "the transfer of information from one location or locations to another location or locations."

It is critical, in our view, that the Bill explicitly negate any possible argument that the provision of an information service dependent upon telecommunications services to move information between the user and the information processing center could be considered to include a telecommunications capability "for hire." For if the use of such telecommunications services by the information service vendor to provide an information service were considered the provision of "for hire" telecommunications capabilities, the entity providing such a service would apparently be classified as a Category I carrier.

The prospect of data processing service vendors being regulated as Category I carriers results also from Section 203(g) of S. 611. This section is directed to the provision of "a telecommunications service either as a separate or integral part of an information or other non-telecommunications service"—referred to as a "joint or integrated telecommunications and information service." The section further provides that "any entity" providing a telecommunications service "either as a separable or integral part of an information or other non-telecommunications service . . . shall be deemed a telecommunications carrier with respect to such telecommunications service." If the provisions of Section 203(g) were to be construed to encompass remote access information services, for the first time—and contrary to long existing policy and judicial holding—this heretofore unregulated marketplace activity would be brought within the scope of federal regulatory jurisdiction. CBEMA believes there simply is no warrant for such a result.

In expressing these concerns, we do not overlook the limiting language of Section 203(a) which provides that "the sale, lease, or other provision of telecommunications equipment, information software, or information services shall not be deemed a telecommunications service" and the admonition that such activities may be regulated "only as provided in this Section." But, as noted, Section 203(g) could nonetheless be read to designate any entity providing a remote access information service—that is, one which uses a communications capability in the provision of an information service—as "a telecommunications carrier with respect to such telecommunications service."

It may be urged by some that regulation of information service vendors as Category I carriers would not be onerous given the Bill's limitations on the FCC's regulation of such carriers. Nonetheless, as the Committee is aware, S. 611 grants the FCC broad discretion to carry out the mandates of the Act, and future years could see growing regulation of Category I carriers and information service vendors despite the Committee's present intentions. Section 211 of the Act, for example, gives the FCC unbounded discretion to require "information relating to telecommunications operations" sufficient to allow monitoring of the carrier's activities or otherwise necessary to the exercise of the FCC's power and duties under the Act. Further, the carrier must update this information as often as necessary to assure its continuing accuracy. Although Section 212, prescribing tariff regulation, applies only to Category II carriers, the information requirements of Section 211 could easily mushroom into a requirement to file the equivalent of "informational tariffs" for some type of Commission review prior to instituting new or changed services.

In addition, the Section 216 notice requirements for Category I carriers with respect to constructing or operating facilities or engaging in telecommunications over new facilities might be read to permit a prior notice requirement, including some form of FCC review process. Finally, under Section 221, the FCC has discretion to prescribe and require the keeping of accounts by Category I carriers, including traffic records.

Despite the benign intent of the framers, therefore, it is entirely possible that a future regulation-minded FCC could subject the information service industry to major common carrier regulation under the jurisdictional mandate of S. 611 if it is construed to treat information service vendors as Category I carriers in whole or in part.

Although the likelihood of a future FCC imposing such regulation on the information industry may seem remote today, even a remote possibility could be cause for concern. Common carrier regulation, even on a Category I basis, would be a disas-

trous burden to an industry which has grown and thrived on the diversity promoted by an unregulated marketplace. Indeed, a hallmark of information service offerings is their ability to be tailored to each customer, both in the equipment selected and in the programs and applications designed. These offerings are clearly distinguishable from common carrier services, which emphasize standardized, basic offerings of transmission capacity, open to any member of the public who wishes to send messages.

The FCC recognized the distinctions between such services and common carrier offerings in its original Computer Inquiry, and it has maintained the regulatory import of these distinctions despite the growing use of computer technology in common carrier offerings. The Congress should similarly make clear beyond any possible question that the use of telecommunications services as one tool in producing an information product or service is not the offering of an ability to send messages for hire, and that it is not a communications common carrier activity.

CBEMA has previously suggested revisions to Section 102 which would limit and clarify federal jurisdiction over telecommunications and electronics equipment. These revisions of Section 102(a) would also delete all references to information services and software and commerce in such items. In addition, Section 203(g) should be deleted in its entirety, leaving the only provisions for FCC action in this area those requiring Category II carriers to form fully separate entities for entering the information industry. If these changes are made and Section 203(a) is left intact, then the Committee will have accomplished its purpose of pre-empting state and federal regulation of information services without giving the FCC unnecessary jurisdiction over competitive, unregulated information service vendors. These proposed changes are also shown in the material attached to this written statement showing how Sections 102 and 203 of S. 611 would read if they were modified as we propose.

II. THE NEED FOR MAXIMUM SEPARATION

A majority of CBEMA members believe that maximum separation between regulated and unregulated services is essential both to safeguard the competitive marketplace for unregulated services and equipment, and to protect consumers of regulated services. As CBEMA has stated previously, the prospect of possible anti-competitive practices must be faced whenever a carrier is providing non-competitive services and regulated or unregulated competitive services from the same or closely related entities. The potential for anticompetitive activity is a problem so long as a carrier has the ability to use financing, research and development, administrative, marketing, manufacturing, installation, and maintenance resources available for his monopoly services, and income earned from those services, to afford a market advantage to its competitively provided services.

In the view of most CBEMA members, a "maximum separation" policy is required to minimize the likelihood of anticompetitive practices in the cross-subsidy, marketing, and other areas. In this view, there is a need for a statutorily imposed prohibition on the provision of competitive services, except through truly separate arms-length subsidiaries with facilities, personnel and offices separate and apart from those of the regulated carrier. While the FCC's "maximum separation" rules may be used as a starting point, CBEMA believes that more definitive requirements covering the areas noted above are necessary.

For example, the legislation should recognize the danger that monopoly derived revenues may be utilized, in conjunction with new or existing endeavors through cross-subsidy or otherwise, to permit unfair competitive practices by a carrier-owned or carrier-controlled entity operating in the competitive marketplace. In sum, CBEMA cannot overemphasize the importance of effective separation measures for regulated carriers seeking to enter unregulated markets.

CBEMA is concerned that the principle of maximum separation may be undercut by the provision in Section 203(b) which allows FCC discretion to depart from the maximum separation policy for Category II carriers which offer information services and the analogous provision for carrier equipment offerings in Section 203(c). CBEMA believes that no such departures from the present maximum separation rule should be allowed. Accordingly, our version of Section 203, as appended, deletes the discretionary departure language. To remove any possible confusion on this point, CBEMA has also added a sentence to amended Section 205(b) to specify that the actions taken pursuant to latter section would not be allowed to alter the maximum separation requirement of Section 203(b).

Recognizing that market conditions and other factors may change in the future, however, CBEMA has added a new Section 203(b)(3) which would require the FCC to report to the Congress in five years whether the policies mandated in Sections 203(b)(1) and (2) adequately protect the public interest. If any changes in policy

would be warranted in view of market developments and regulatory actions during this five-year period, Congress can authorize such changes on the basis of the FCC report and other pertinent material. At the least, a timely review of basic policies will be required.

III. CERTAIN OTHER POINTS SHOULD BE CLARIFIED IN THE LANGUAGE OF THE LEGISLATIVE HISTORY OF S. 611

Our statement thus far has urged limited FCC jurisdiction over equipment and no jurisdiction over information services, including those which use telecommunications services to facilitate input of information and delivery of processed products. In the final drafting of a committee Bill and in its legislative history, a number of other points should be considered, some of which will be mentioned only briefly today.

S. 611 recognizes a need for an orderly transition period between the regulation of common carriers we know today and the system of Category I and II carriers which this Bill provides. To avoid unnecessary litigation, the Congress should make clear the major FCC policies and interpretations under the Communication Act of 1934 which will remain in effect under the new Bill, and those major policies and interpretations which are being specifically overruled or changed in important respects. The reports accompanying the legislation could do much in this respect. Moreover, a prompt but realistic time-table should be specified for those carriers which must eliminate equipment offerings from their tariffs and set up fully separate entities if they wish to continue in the equipment business.

Implementation of new legislation, including an orderly transition, would also be facilitated by additional attention to definitions of phrases and terms such as services "not subject to effective competition," or the various "markets" for telecommunications services and "similar services" within those markets. CBEMA recognizes that prescribing such definitions involves the most difficult kind of economic judgments and that precise solutions may not always be feasible. Still guidance is needed as to Congressional intentions regarding the complex and sophisticated judgments the Commission will be asked to make, or the result may be endless confusion and litigation.

Lastly, in the area of international communication, CBEMA members are concerned over the changes proposed and their possible impact on large users of international services. Many CBEMA companies conduct extensive operations overseas and thus make extensive use of international communications services. At this juncture, however, CBEMA's evaluation of the plan to set up an International Facilities Management Corporation and transfer the U.S. portion of international facilities to it will await the comments of those parties most directly affected.

IV. ADDITIONAL COMMENTS CONCERNING S. 622

Mr. Chairman, S. 611 is broader in scope than S. 622; however, the treatment of a number of areas in S. 622 should, in our view, be taken into account as the Committee develops any future proposed legislation. Thus, S. 622 explicitly recognizes the timetables needed to implement an orderly transition between the scope of regulation imposed on carriers today and the largely deregulated marketplace contemplated in the near future. The transition plan contemplates classification of carriers, the implementation of needed accounting rules and a determination regarding separate subsidiaries required for monopoly carriers to engage in unregulated activities. While CBEMA has some questions whether complete deregulation can be accomplished within a six-year period, we support the establishment of a target period within which every effort is to be made to achieve that objective.

S. 622 also avoids any hint of regulating information services by limiting its definition of telecommunications services to transmission of signals by a common carrier and only the receipt, forwarding and delivery activities incidental to transmission. No attempt is made to separate information services into any constituent communications portions or to regulate information service vendors as resellers of communications. In the use of the term "common carrier" and in the retention of large portions of present law under the Communications Act of 1934, S. 622 would further carry over the basic right of customers to interconnect equipment and private communications systems to the services of common carriers. As the Committee is considering its final legislation, the approach of S. 622 should receive serious attention as one method of confirming these important points while leading to the deregulated marketplace which most parties and both bills enthusiastically support.

Mr. Chairman, again I want to thank the Subcommittee for giving me the opportunity to appear before you today. I will be happy to answer any questions you may have about the points I have discussed.

"APPLICATION OF ACT

"Sec. 102. (a) The Congress finds and declares that, whereas modern efficient interexchange telecommunications services and facilities are essential to interstate and foreign commerce and whereas technological advances have led to a convergence of interexchange telecommunications services and facilities, such that it is no longer possible to distinguish between interstate interexchange and intrastate interexchange telecommunications simply on the basis of State boundaries without creating artificial and irrational barriers which are a burden on interstate and foreign commerce and which will reduce the benefits otherwise accruing to the public, the provisions of this Act shall apply to and the Commission shall exercise jurisdiction with respect to: all interexchange and international telecommunications and all transmission of electromagnetic energy by radio which originates and/or is received within the United States; [all commerce in telecommunications and electronics equipment and services, information software, and information services]: the licensing and regulating of all radio stations as hereinafter provided; and all persons engaged within the United States in such telecommunications or such transmission of energy by radio [or such commerce].

"(b) Except as otherwise provided in title II, and subject to the provisions of section 301 of this Act, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to charges, practices, services, facilities, or regulations for or in connection with exchange telecommunications services which do not form part of an interexchange service."

Sec. 102(c) The Congress finds and declares that whereas, a competitive, unregulated marketplace for customer premises equipment used with common carrier telecommunications services best serves the interests of consumers in a diversity of equipment choices, the provisions of this Act shall apply to and the Commission shall exercise jurisdiction over the use of such customer premises equipment only to the degree necessary to prevent technical harm to common carrier services and facilities regulated under Title II of this Act. Congress further finds and declares that customers have a statutory right to connect customer premises equipment and private telecommunications systems to the services of intraexchange carriers and Category II carriers regulated under Title II, so long as such connections comply with any rules and regulations of the Commission containing technical interface specifications designed to prevent technical harm to such carrier services and facilities.

"TELECOMMUNICATIONS AND ELECTRONICS EQUIPMENT, INFORMATION SOFTWARE, AND INFORMATION SERVICES

"Sec. 203. (a) The sale, lease, or other provision of telecommunications equipment, information software, or information services shall not be deemed to be a telecommunications service within the meaning of this Act. Such activities shall be subject to Federal and State telecommunications regulation only as provided in this section.

"(b)(1) No carrier classified as a Category II carrier under section 204, and no carrier which provides an exchange telecommunications service for which such carrier is not subject to effective competition, shall sell, lease, or otherwise market any telecommunications equipment or electronics equipment, information software, or information service, except through a fully separated entity, [unless the Commission determines after hearing that conditions for effective competition in the relevant market or markets, and the interests of telecommunications service consumers, can be adequately protected through appropriate accounting or structural safeguards prescribed under section 205(b)].

"(2) Any carrier classified as a Category II carrier under section 204, and any carrier which provides an exchange telecommunications service for which such carrier is not subject to effective competition, shall be fully separated from any affiliated entity which produces or provides any telecommunications equipment or electronics equipment, information software, or information service, [unless the Commission determines after hearing that conditions for effective competition in the relevant market or markets, and the interests of telecommunications service consumers, can be adequately protected through appropriate accounting or structural safeguards prescribed under section 205(b).]

"(3) Five years following the effective date of this Act, the Commission shall submit to Congress a detailed report with respect to the implementation of subsections (1) and (2), above. Such report shall include an analysis of the pertinent markets, the effectiveness of the requirements of subsections (1) and (2) to meet consumers' needs, and any recommendations for further legislation.

"(4) A State commission may permit any exchange carrier which, in conjunction with any affiliated carrier, provides only public message exchange services within the boundaries of such State to sell, lease, or otherwise to market any telecommunications equipment or electronics equipment, information software, or information serv-

ice within such State where such State Commission determines that the requirements of paragraphs (1) and (2) of this subsection relating to full separation would be unreasonable because of the small size of such exchange carrier.

["(c) No carrier classified as a Category II carrier under section 204 shall offer telecommunications equipment as an integral part of a telecommunications service, except as the Commission may allow under such conditions as it may prescribe under section 205(b).

["(d)(1) The Commission may establish and enforce such requirements with respect to design, manufacture, and maintenance standards for telecommunications equipment and electronics equipment intended to be connected with any telecommunications network as are necessary to protect such network from unacceptable technical or operational harm, and to foster competition in the relevant telecommunications equipment, electronics equipment, information software, and information services market or markets.】

“(c) The Commission may establish requirements relating to labeling of equipment intended to be connected with telecommunications services or intraexchange and Category II carriers to indicate the country of origin and to provide the consumer such information as the Commission deems will be of significant interest.

“(d) Except as provided in subsection (c) of this section, the Commission will impose no requirement and exercise no control over any person not a telecommunications carrier which is engaged in the supply of any telecommunications equipment, electronics equipment, information software, or information service.

“(e) No State shall impose any special requirement upon the manufacture or marketing of electronics equipment which is, or is intended to be, used in or connected with any telecommunications system, other than a requirement generally applicable to the manufacture or marketing of other electronics equipment.

["(c) Any entity which provides a telecommunications service either as a separable or integral part of an information or other nontelecommunications service (hereinafter in this subsection referred to as a joint or integrated telecommunications and information service) shall be deemed a telecommunications carrier with respect to such telecommunications service. Whenever the interexchange transmission portion of any such service is accomplished, except for incidental segments thereof, solely through the lease and resale of telecommunications facilities or services provided by a fully separated or nonaffiliated carrier under nondiscriminatory conditions with respect to other carriers and providers of information service, such entity shall be designated and regulated as a Category I carrier under section 204. Whenever the interexchange transmission portion of any joint or integrated telecommunications and information service is accomplished in substantial part by means of telecommunications facilities owned by or under substantial control of such entity or of an affiliated entity which is not a fully separated entity, the Commission shall consider the extent to which such entity is subject to effective competition in the provision of such joint or integrated telecommunications and information service in determining whether such entity should be designated and regulated as a Category II carrier under Section 204 with respect to the telecommunications service.”】

PREScription OF CARRIER REQUIREMENTS

“SEC. 205. (a) Consistent with the purposes of this Act and the policy of this title, the Commission may prescribe different requirements for different categories or subcategories of carriers, different classes of services, or combinations of carriers and service classes: *Provided*, That, with respect to Category I carriers, the Commission shall impose no requirement except as otherwise specifically provided in this title.

“(b) With respect to Category II carriers, the Commission may prescribe such conditions governing the provision of any interexchange telecommunications service, as the Commission deems necessary and appropriate to insure that the initiation or continued provision of any such service by such carrier is consistent with the policy of this title. As to any telecommunications market wherein competition either exists or is capable of developing, such conditions shall be designed to protect the competitiveness of such market by preventing cross-subsidization and other anticompetitive practices and to protect the interests of consumers of noncompetitive telecommunications services. Such conditions may include but are not limited to: reporting of information; accounting rules; authorization of facility construction and use; approval of tariffs; interconnection of consumer equipment; and any other requirement relating to corporate ownership of organization. In addition, the commission may impose any requirement relating to separation of such carrier's telecommunications services from such carrier's nontelecommunications activities or services, or from the nontelecommunications activities or services of any affiliated

entity; or relating to separation of such carrier's telecommunications services for which it is subject to effective competition from those telecommunications services for which it is not subject to effective competition. *Provided, however, that the provisions of this Section shall not be construed to override or alter the requirement for fully separated entities imposed in Section 203(b).* The Commission may also prescribe joint operations among Category II carriers, or among such carriers and Category I carriers, award an exclusive franchise to one or more carriers, or impose such other requirements as the Commission deems necessary to ensure the provision of an essential public service.

ATTACHMENT I

CBEMA Companies 1979

3M Company	Lanier Business Products, Inc.
A. B. Dick Company	Liquid Paper Corporation
Acme Visible Records Inc.	Litton Industries, Inc.
Addmaster Corporation	Micro Switch, Div. of Honeywell Inc.
AM International, Inc.	NCR Corporation
AMP Incorporated	North American Philips Corporation
Burroughs Corporation	Olivetti Corporation of America
Control Data Corporation	Pitney Bowes
Dennison Manufacturing Company	Sanders Associates, Inc.
Dictaphone Corporation	Sony Corporation of America
Digital Equipment Corporation	Sperry Univac
Eastman Kodak Company	TRW Communications Systems & Services
Exxon Enterprises, Inc.	TAB Products Company
GF Business Equipment, Inc.	Tektronix, Inc.
General Binding Corporation	The Standard Register Company
Harris Corporation	Uarco Incorporated
Hewlett-Packard Company	Xerox Corporation
Honeywell Information Systems Inc.	
IBM Corporation	

ATTACHMENT II

CBEMA,
INDUSTRY NEWS,
Washington, D.C., March 21, 1979.

FAVORABLE BALANCE OF TRADE HITS \$2.8 BILLION FOR 1978

WASHINGTON, D.C.—The favorable balance of trade for office, computing and accounting machines and copiers in 1978 increased 22.3 percent over 1977, according to the latest statistics released by the Computer and Business Equipment Manufacturers Association, (CBEMA).

The CBEMA statistics, which were compiled from U.S. Department of Commerce data, show a \$2,872,819,405 favorable balance of trade for the industry—an increase of over \$500 million over the 1977 year-end figures. Although the first quarter showed only a moderate increase of 5.5 percent over 1977, the fourth quarter hit a four year high of 38 percent over the previous year.

Total exports were up from \$3.9 billion to \$5.1 billion while imports rose from \$1.6 billion in 1977 to \$2.27 billion in 1978. About 25 percent of the increase in exports was due to an increase in sales of computers and related equipment. The total increase in exports of computers and related equipment in 1978 over 1977 us \$303,882,784.

In addition, the ratio of exports to imports for 1978 is 2.26.

Commenting on the new record, CBEMA President Vico E. Henriques stated, "Trade has become a vital element to the nation's overall economic well-being. The business equipment and computer industry sector has continually contributed to the nation's strength and the figures for 1978 illustrate that fact. Despite the many trade barriers facing high technology industries, both externally and internally, CBEMA member companies continue to grow and be an important factor in an interdependent world."

[The following information was subsequently received for the record:]

ADDITIONAL COMMENTS OF THE COMPUTER AND BUSINESS EQUIPMENT
MANUFACTURES ASSOCIATION (CBEMA) UPON S. 611 AND S. 622

CBEMA submits these further comments to its statement of May 2, 1979, to reiterate and amplify its stated concerns, in the light of the testimony which has been given.¹ These concerns are:

1. that the Commission's jurisdiction be limited to the regulation of telecommunications services;
2. that there be no regulation of data processing and other information processing equipment or services markets;
3. that all customer premises equipment be deregulated;
4. that cross-subsidization and other anticompetitive practices be prevented by requiring maximum separation between a carrier's competitive and monopolistic service offerings; and
5. that there be government support of private sector representation in international telecommunications meetings.

Because many of our positions on these concerns have met with general acceptance from virtually all major parties to the legislative debate, the following discussion focuses on those matters which, upon review of the testimony presented to the Committee, appear to warrant additional comment.

MAXIMUM SEPARATION

CBEMA has maintained that maximum separation of competitive and monopolistic carrier activities is a prerequisite of effective competition. Representatives of the Bell System have expressed a need to allow both vertical and horizontal integration, arguing that the maximum separation requirement would significantly hinder the planning and operation of an integrated transmission network. CBEMA's position is not, however, inconsistent with A.T. & T.'s concern for the continued integrity of the nationwide telephone network.

The arguments of the Bell System against maximum separation must be examined in light of the extent to which the integrated planning and management of what A.T. & T. now calls the "core network"² would, in fact, be affected by the imposition of maximum separation requirements. The CBEMA position accommodates rather than threatens the continued integrated and planned operation of this core network.

The Bell System aspires to provide services ranging from the most characteristic of a public utility—local exchange and message toll to residence customers and business—to the least characteristic of a utility, such as the many competitive equipment offerings and data processing services (offered as a component of network services or separately). In this range, basic private line services and DDS, the primary private line services available on a widespread basis, fall closer to the utility services end. Enhanced non-voice services would logically fall toward the fully competitive or non-utility services.

CBEMA agrees that the Bell System and the approximately 1500 independent carriers should continue to have broad, although not unlimited, leeway to take the steps necessary to assure the planning and operation of a smoothly functioning core network. From this perspective, we have not asked Congress to "break up" the Bell System, nor do the pending legislative proposal, fairly read, call for such a disruption of the present telephone network. These entities will maintain the responsibility and authority for the operation of the core network used to provide public switched services just as they do now. This is not inconsistent in any way with a full separation requirement for the provision of terminal equipment and data processing services, and also for telecommunications offerings providing more than basic transmission service.

ACS presents a good example. As proposed, it would compete with the packet-switched services of Telenet and Tymnet and, in some respects, with unregulated data processing services. The operation of ACS on a fully separated basis, with A.T. & T. obtaining basic transmission services from the core network on the same basis as its competitors obtain such service, would not undermine the integrated

¹ CBEMA's membership represents a wide variety of interests. Individual members may have differing views on some of the particular questions raised or may not have reached definitive judgments on particular issues. This statement, however, presents the majority view of CBEMA's members on the concerns raised by S. 611 and S. 622.

² The term "core network" as used by A.T. & T. would seem to refer to the basic transmission and switching facilities and capabilities to provide basis switched and private lines services and we use the term here in that sense.

planning and management of the core network.³ In fact, A.T. & T. proposed to utilize additional facilities essential to the provision of ACS which are not even part of the core network (e.g., network nodes and access controllers).

Basic analog and digital private line services present different considerations. CBEMA noted in its statement that A.T. & T. is by far the pre-eminent supplier of these basic services throughout the country, and the essential role of private lines as the foundation for the development of competitive services by resale carriers and unregulated service vendors places such services closer to the utility-type local exchange and message toll services. Additional flexibility may be needed for the FCC to permit less than full separation with respect to the provision of basic private line services. Full separation of such offerings must, however, be imposed to the extent the Commission finds that integrated network planning and operations will not be endangered.

In this connection, the CBEMA position both before Congress and the FCC has been that, at most, common carrier regulation should be confined to the provision of basic switched and private line services. Even within these areas, there should be reliance upon a competitive marketplace to the extent that this is consistent with assuring the availability of such basic services. We endorse FCC flexibility to deregulate basic private line services when competition in this area is adequate to promise the availability of needed services on a competitive basis. In the interim, if all private line services are available for resale, at tariffed rates, the Bell System would have fewer opportunities to favor its own competitive endeavors.

In sum, the full separation policy supported by CBEMA is not inconsistent with the central concern of A.T. & T., i.e., the ability to plan and manage an efficient, integrated core network. The imposition of such a requirement upon the monopoly carriers (for customer premises equipment, data processing services and enhanced services) will not jeopardize the availability of basic transmission and switching facilities and capabilities necessary to provide nationwide, diverse telecommunications services. Such maximum separation supplemented by appropriate accounting controls will not only assure full and fair competition for telecommunications equipment and services, but equally important, will shield the captive ratepayers from the risks of competitive ventures.

INTERNATIONAL COMMUNICATIONS

Users of international services often face significant obstacles in negotiating for services (and standards of service) they need overseas. CEBMA has advocated representation of users on U.S. delegations and working groups associated with international telecommunications organizations such as the ITU, including its CCIR and CCITT affiliates. At a minimum, the new legislation should institutionalize such user participation to assure a substantial proportion of effective user representation in the international arena.

The legislation should also direct that non-government interests be provided the aid of the U.S. government, to the extent feasible, in their international business-related negotiations with foreign telecommunications entities that are of general applicability to all similarly situated interests. Foreign telecommunications administrations often will not accept competition in the provision of telecommunications services and therefore are opposed to any proposal to offer services that may compete with their present or planned services. Many of these administrations are owned in whole or in part by the government of the country involved, and the need voiced most often by U.S. companies in these circumstances is for stronger support from the U.S. government to counterbalance the weight of the government on the other side.

Specific steps to aid U.S. interests in these areas may be difficult to specify in legislation. However, the attached suggested general amendments on these points would, we believe, be most helpful to solving international users concerns.

TARIFF REVIEW PROCESS

The mechanisms for tariff review of regulated telecommunications services did not receive extensive attention during the hearings. CBEMA has concluded that the tariff review provisions contained in S. 611, on the whole, provide useful protection to user interests. However, the 90-day tariff review period for non-competitive

³ Without maximum separation or comparable safeguards, A.T. & T. would be able to obtain the core network facilities for ACS on a cost-sharing basis, while ACS' competitors could only obtain basic A.T. & T. private line—such as DDS—and exchange services at tariffed rates. This would constitute an immediate unfair competitive advantage, while adding nothing to the planning or integration of the core network facilities.

services and the 30 day tariff review period for competitive services are too short for thorough review, and consideration should be given to lengthening these time limits. We call your attention to our earlier comments on these provisions.

OTHER MAJOR CONCERNS

CBEMA's testimony on May 2, 1979 also emphasized a number of other important concerns. We addressed the justification and desirability of deregulating the provision of terminal equipment. We also extensively discussed our strong position that there should be no regulation of data processing services at either the state or federal level.

CBEMA specifically addressed the language of S. 611 which would give the FCC "jurisdiction" over "all commerce" in "information services and software" and the possibility that the FCC might attempt to classify data processing service vendors as resale carriers to the extent that their systems offerings incorporate communication lines. We do not believe such an extension of regulation was intended by the provisions of S. 611. CBEMA has, nevertheless, suggested revisions which would remove the threat of any such regulation. We call particular attention to those suggested revisions.

All major parties have supported these positions or generally stated their acceptance of solutions like those suggested by CBEMA. Such support among many interests suggests, we believe, a consensus for these positions which compels that they be reflected in the legislation.

CONCLUSION

CBEMA believes the Committee has an historic opportunity in this legislation to structure a competitive telecommunications market while also assuring the availability of reliable and economical nationwide network facilities. CBEMA urges the inclusion of its proposals in the legislation.

[Attachment]

AMENDMENTS TO S. 611 TO PROTECT USER INTERESTS IN INTERNATIONAL TELECOMMUNICATIONS SERVICES

COMPOSITION OF U.S. DELEGATIONS TO INTERNATIONAL TELECOMMUNICATIONS ORGANIZATIONS AND CONFERENCES

The United States delegation to any meeting, working group or preparatory effort of or for an international telecommunications organization or conference shall include substantial representation of user interests in international telecommunications services. Such representation shall be designed to encompass effectively a representation recognizing the diverse and important non-government as well as government dependence upon the availability of a variety of rapid and efficient international communication services at reasonable charges.

NEGOTIATION OF PRIVATE USERS FOR INTERNATIONAL TELECOMMUNICATIONS SERVICES

The Agency is hereby directed to establish and implement procedures to lend the aid of the United States Government to private U.S. parties, whenever feasible, in their negotiations with foreign telecommunications entities over conditions or terms of service of general applicability to all similarly situated interests between the U.S. and overseas points and between and among overseas points.

Senator HOLLINGS. Thank you very much.

Mr. McGowan, welcome back.

Mr. MCGOWAN. Thank you, Mr. Chairman. I am Bill McGowan from MCI Communications Corp.

In U.S. telecommunications, just as regulation is the surrogate for competition, so regulation, in the present legislative environment, has been suggested as a surrogate for meaningful structural reform that will accelerate the transition from monopoly to competition along sure and lasting paths.

From a competitor's viewpoint, I perceive the structural issue as divisible into four central points.

First, there is a distinct physical and operational entity known as the local exchange carrier. Whether this entity calls itself

C. & P. Telephone Co. of the District of Columbia, or United Telephone, Rochester Telephone, Winter Park Telephone—by whatever name it is known, the local exchange carrier is distinct. Equally distinct, from physical and operational points of view, is an entity known as the interexchange carrier. Whether this entity calls itself A.T. & T.'s Long Distance Network, MCI, or a private microwave system, or a satellite carrier—by whatever name it is known, the intercity carrier's function is distinct.

These two distinct types of entities interface with one another in several separate relationships:

To begin with, there is an operational relationship, conducted by operating people, generally at the craft or clerical level. This relationship involves such daily chores as scheduling, installing, testing, and maintenance, and occurs routinely on a daily basis.

The next relationship between local and intercity carriers is planning, conducted by technical specialists. This relationship involves such routine tasks as setting new terminal locations, new switch installations, network expansion plans, future capacity requirements, site selection, microwave frequency coordination. This relationship, too, occurs routinely as occasion requires.

The next relationship is—or should be—engineering, involving all forms of system interface between local and intercity carriers, specifically including standards, signalling interface, and new improved technological handshakes. It is a relationship conducted throughout this country and around the world, under the auspices of the CCITT internationally. It, too, is a routine relationship, conducted by and between professionals.

Senator HOLLINGS. Can you hold up for a minute? Senator Cannon will be back, but I have to catch a rollcall.

Thank you.

[Recess.]

The CHAIRMAN. The committee will come to order.

Mr. McGowan, you may proceed.

Mr. MCGOWAN. Thank you.

The last of these relationships is economic, and involves policy-makers and policy issues. Simply stated, this all boils down to two simple questions: Who pays what in the relationship, and who gets what from it?

My second point springs from these relationships. They confirm the fundamental necessity of the local carrier to the provision of interexchange service, because that carrier is a monopoly. Precisely because of this bottleneck status, each local exchange carrier must treat each interexchange carrier fairly, honoring its requests for interconnection on the same terms, conditions, rates, and technical characteristics as it does each other carrier's request, including any with which it is affiliated.

My third point examines the facts today regarding the evenhandedness of these basic relationships between the local exchange carriers and the various interexchange carriers who seek access to their facilities.

The operational relationship is, from MCI's point of view, satisfactory insofar as it goes; normal people doing their daily jobs.

The planning relationship is just fruitful enough to establish that it could be bountiful if the local carrier perceived MCI as anything

but an enemy, an antagonist, someone with whom it really does not want to do business. So, I would characterize this relationship as of limited effectiveness today, but with possibilities for salutary improvement.

The engineering relationship simply does not exist. A.T. & T. has instructed the local Bell exchange carriers to deal with MCI in this area only through A.T. & T. As a consequence, MCI continually petitions A.T. & T. for the level of interface that any interexchange carrier needs, only to be turned down point blank by 195 Broadway, in most cases.

For example, rotary dial telephone interconnection. Local exchange carriers could supply this interconnection to us within hours. But A.T. & T. says no. That means you or any member of the public who wishes to use MCI's metered service can only do so from a touch tone phone and not rotary phones.

The economic relationship is, of course, the real source of all the difficulties experienced by MCI in the previous three, because it is the economic relationship that A.T. & T. uses to keep the local exchange carriers completely under control. As it is axiomatic that the power to tax confers the power to destroy, so it is equally true that the control of corporate funds confers the power to dictate. And through its control of the separations and settlements process, A.T. & T. controls the revenue levels of the local exchange carriers, and hence, exercises a dictatorship over the entire local exchange industry. Separations and settlements lock the local exchange carriers in a partnership with A.T. & T. from which they acquire the incentive to treat A.T. & T.'s long-distance network altogether differently—and much more favorably—than MCI's network, or anyone else's, for that matter.

My last point raises the question how this is to be solved—for this is the question that must be answered as a necessary precondition to effective competition in the telecommunications industry.

My conviction, based on a decade's experience of dealing with A.T. & T., is that the answer requires positive action to eliminate the structure that dictates the behavior that discriminates among otherwise legally, technically, and professionally competent competing intercity carriers.

This restructuring requires that every local exchange carrier be paid by every interexchange carrier on an absolutely equal basis, and that the method of payment from each intercity carrier be exactly the same. No more big pool of funds eddying ceaselessly in concentric circles, of whose beginning and of whose end there is neither glimpse nor trace. Only this will insure that the other three relationships—the operational, the planning, and the engineering interfaces—have the transparency and inherent fairness that the bottleneck rule of antitrust law requires.

Just to be certain that there is no confusion as to this last point, I believe that the Congress should legislatively mandate precisely this transparency in a local exchange carrier's dealings with each and every interexchange carrier.

This done, the next step would be to revise the industry's corporate structure to insure that there would no longer be any common parent relationship between an interexchange carrier and a local exchange company. The two parties in the transparent relationship

should have no incentive to muddy the relationship through concern for interests other than those of the relationship itself. This could be achieved by a stock dividend to all present shareholders—a simple but fair method used in similar circumstances in the past.

Alternatively—and at a minimum—I believe the divorcement between local and intercity carriers should be expressed through fully separated entities, as called for in S. 611. These should be so separated that any discrimination by a local carrier in favor of any intercity carrier, would immediately be obvious, and thus readily remedied by the courts—or by the Commission, which should have the jurisdiction to effect such relief.

These conclusions rest on my conviction—one born of years of sad and sobering experience—that A.T. & T.'s pattern of behavior in seeking continually to monopolize is so ingrained as to be otherwise ineradicable.

As exhibit 1 of the proof of my contention, I urge you to consider the testimony that A.T. & T.'s Mr. Olson will probably present to you this afternoon.

If he runs true to form, Mr. Olson—just like A.T. & T. Chairman Brown before him—will describe four provisions that any legislation must have if it is to secure the Bell imprimatur. It is clear, from the dialog before the House subcommittee, that A.T. & T. is still seeking the essentials of the Bell bill, which it presented to Congress in 1976. It has just repackaged its proposals to conceal its real intent.

The term core network is a new term invented for these hearings. Even A.T. & T.'s independent telephone partners admit this is the first time they heard it and they don't understand it. You will have the impression, in the House, that there is imminent danger of a core meltdown. Known in the industry as the Theodore Vail syndrome.

Second, Mr. Olson will describe the economic incentive system that reportedly keeps the contraption from falling on its face by paying off the proponents of the core network out of the pots of money collected from the ratepayers. Senator Hollings was perfectly correct in referring to this as the industry's candy jar.

Third, Mr. Olson will describe why the provision of basic services should be given as a legislative charter to the existing industry, a fitting tribute to the best arm-in-arm teamwork that ratepayer money can buy. What he is asking for, of course, is a new monopoly at the very heart of the business, a new monopoly against which no one could compete.

And the last thing Mr. Olson will discuss, though in different terms, is the need for antitrust immunity while all his previous objectives are achieved.

I submit that the price of such legislation is too high for the American people to pay, too high in terms of innovation lost, diversity deprived, technology frustrated. But he will ask it of you nonetheless.

Which is why I hope that you will ask Mr. Olson to make available to this subcommittee the documents relating to A.T. & T.'s dealings with its competitors, documents gleaned from the various active antitrust suits pending against it. I am convinced, naturally, that these documents, which relate the story of

A.T. & T.'s relationships with MCI, ITT, Datran, Southern Pacific, Litton, and others, will demonstrate conclusively that A.T. & T. has violated, continues to violate, and has plans to persist in violating the antitrust laws of the land.

And if Mr. Olson turns you down, as he did yesterday in the House, then I would recommend that you subpoena the material in question. Only with that information in hand will you ever really have the insight you need to understand corporate A.T. & T.

Thank you.

[The following information was subsequently received for the record:]

MCI COMMUNICATIONS CORP.,
Washington, D.C., May 29, 1979.

Hon. BARRY GOLDWATER,
Russell Senate Office Building,
U.S. Senate, Washington, D.C.

DEAR SENATOR GOLDWATER: At the conclusion of my testimony before the Senate Subcommittee on Communications on May 2, 1979, I promised to supply the Subcommittee, in response to a question you had asked earlier, with a model structure demonstrating the physical, operational, and technical parameters which would permit the local exchange carriers and the interexchange carriers, as completely distinct and separate entities, to interconnect with each other for the provision of high quality communications service. I also stated that there are no problems in effecting interconnection between the specialized carriers and the telephone network and that such interconnection poses no threat to the integrity of that network.

I am enclosing, herewith, a report entitled "The Proposed New Intraexchange-Interexchange Structure" which indicates the feasibility of the proposed network structure and also shows how the specialized carriers can interconnect and function with the established telephone network. This is a preliminary feasibility analysis prepared for MCI by Transcomm, Inc., a group of consultants in engineering and economics. This organization has been involved in all aspects of federal and state regulation of telephone systems for over ten years.

I hope you will take the time to read this report, which is not a very long one. I think it will respond to the question you were raising because it demonstrates that MCI and other competing carriers can interconnect with the local exchange telephone companies at the class 4 central office level without in any way disrupting normal telephone operations. It points out that the technical details of such interconnection can be worked out within the existing framework for inter-carrier coordination, and that the economics of the situation can be taken care of by means of local network access charges to be imposed equally upon all interexchange carriers—AT&T as well as the specialized carriers. A conclusion that can be drawn from this report is that AT&T's present long distance operations, or any new entity that might be created to own and operate the Bell System's interexchange facilities, could also be a fully separate corporation and interconnect with the local exchanges in the same way as the specialized carriers.

I greatly appreciate the opportunity to appear before the Subcommittee and to supplement the record with MCI's views as to the pending legislation. I am sending copies of this letter and of the enclosed study to the staff of the Subcommittee for inclusion in the record. I want to thank you for your interest in these important matters.

Very truly yours,

WILLIAM G. MCGOWAN,
Chairman of the Board.

Enclosure.

THE PROPOSED NEW INTRAEXCHANGE—INTEREXCHANGE STRUCTURE

SUMMARY AND CONCLUSION

A review of the current legislative proposals to restructure the existing interstate-intrastate jurisdictional telephone operations into interexchange and intraexchange operations indicates that this proposal appears feasible. A brief review of the existing toll-switching system hierarchy in the United States indicates that the proposed demarcation for such restructuring can be focussed at the class 4 toll center offices within the existing system. Moreover, it would appear that the specialized common

carriers could interconnect at this level to provide interexchange services without creating any technical or economic problems that cannot be resolved within the existing framework and procedures used for inter-carrier coordination and compensation. In this way, competitive "parallel" service networks could be developed compatibly with the existing network hierarchy.

REVIEW

Specialized common carriers (SCCs) in the communication field depend upon local telephone service for distribution to and from their terminals or switches to subscribers for their services. In most cases, they are limited in completing a connection and have other distributional limitations due to the necessity of interconnection to only a local telephone exchange in a given area. Under the existing system organizational framework, network access is made through what is known as a class 5 office or local exchange. The procedure could be simplified, network access expanded, and end-to-end cost perhaps lowered if arrangements could be made to enter the national toll network at a level higher than a local exchange. These deficiencies can be overcome by adopting the presently proposed legislation which will redefine the current jurisdictional state-interstate toll structure into an intraexchange and interexchange structure.

The inherent compatibility of the existing and proposed structures is best explained by examining the hierarchy of the existing national toll network.

In the toll system plan for North America, including Canada, Mexico, the Maritime Provinces, and the United States, these areas have been divided into a number of Regions. Each Region has been subdivided into Sections. In turn, the Sections are further subdivided into Primary Areas; all very much like the geographic divisions and subdivisions of the United States.

There are toll switching centers for each level of the subdivisions as shown in Fig. 1, the Basic Toll Network. Within the Primary Area there is further subdivision in order to bring the system down to a local area and connections to the individual subscriber. Each level or stage of progress in the hierarchy has been assigned a class number with the largest number being given to the local exchange.

Traffic in the long distance services is routed via the various switching centers to the Regional center prior to being connected to another Region. Traffic within a Region goes through the next higher center to travel to the adjacent area. The network pattern is illustrated in Fig. 2, Interconnecting Pattern; thus, the term "the Toll System hierarchy."

As a means of further illustrating the system concept, let's follow a call from a telephone station in Washington, D.C. to the west coast. The call is routed from the immediate neighborhood to the 13th Street office, then to "Garden City", Virginia, across the river. From that point, there are direct trunks to San Francisco (a Region to Region connection) at which point the distribution process takes place. What has happened in this arrangement is that the initiated traffic is concentrated in stages to make use of a common facility for transmitting over long distances. Then there is a decentralization or distribution to reach a local station in the called area.

In rural areas the hierarchical relationships, including independent telephone companies, are essentially the same. Consider, for example, New London, Minnesota, which has an independent telco providing service to about 2000 stations. The class 5 independent office is tied into a Bell System class 4 toll center at Willmar and then the Sectional center at Minneapolis and ultimately to the "Norway" Regional center in Illinois. Thus, a long distance call originating in rural New London, terminating in Sacramento, California, would follow this path to the Regional center in Sacramento for completion at that end.

In some cases, depending upon traffic demands, a number of Regional offices may be interconnected directly to each other. Thus, there are direct trunks from east coast to west coast, or Washington to Chicago, or Atlanta to Chicago. Where the amount of direct traffic does not support a direct trunk system, the connection may be relayed through one or more Regional offices. Under conditions of unusually high traffic demands, the calls may be routed over alternate routes between Regional offices and, as well, Sectional offices as shown in Figs. 2 and 3.

One method of interconnecting and alternate routing is shown in Fig. 3. Also in this figure, it is shown that in the interest of economies (e.g., minimize the number of switches and switching points) all offices in the system organization are designed to perform the functions of several levels. That is, a class 2 office can handle the class 3 and class 4 traffic as well. Certain technical criteria have been established with the objective of keeping the traffic as low as possible in the hierarchy on an equitable (i.e., traffic density) basis, while maintaining capacity within the hierarchy for both alternate routing and normal hierarchical routing. Thus, the entire scheme has been designed to be flexible in the many arrangements needed. A

graphic representation of the current toll hierarchy within the United States is shown in Fig. 4.

The intricacies by which switching takes place in every one of these centers are technical details that have been omitted for purposes of this discussion. It is sufficient to state that each switching point is tailored to meet the immediate requirements of its location, quantity of traffic to be handled and call routing. The circuit quantities and facility arrangements are normally determined by traffic studies for the circuit quantities and economic selection for the facilities (e.g., present worth of annual charges). Ultimately these data are negotiated and mutually agreed upon by the different companies involved.

The problem addressed in this document is the potential for establishing an intraexchange-interexchange delineation of this network hierarchy and the potential for access to this "new" structure by the specialized carriers without disturbing the techno-economic relationships established within the current structure.

Initially, it is interesting to note that A.T. & T. appears to view its current local office interconnections for its own local and toll offices in much the same way it views interconnection for the specialized carriers. For example, Figs. 5 and 6 (taken from materials submitted by A.T. & T. during the ENFIA negotiations) show the specialized carrier facilities (MCI-EXECUNET and Southern Pacific-SPRINT) as merely being interposed between local/central offices, acting in lieu of the class 4 toll office and toll trunk connections within the existing A.T. & T./Bell toll hierarchy. As the narrative attached to these figures indicates, the customer is operationally indifferent to the configuration chosen, except for the local dial-in to the specialized carrier.

Moreover, from a technical point of view, both the specialized common carrier and the long lines company would appear similar at the class 4 toll office level. Each could interconnect at that level for completion of a circuit to the designated class 5 or local office. As Fig. 7 shows, this level at which interconnection would occur is also compatible with a definition of intraexchange service which encompasses the class 4 and 5 offices while interexchange service, also interconnecting at the class 4 office, is provided as a services network which is "parallel" to higher levels of the long lines toll hierarchy.

It would be necessary for all interexchange carriers to establish with the local operating (intraexchange) company specifications for the interconnection and method of operation. There are office and interoffice trunking schemes which may be used for connections of this type.

Trunking schemes between class 4 offices sometime vary to meet different signaling and termination practices, dependings on the type of switching equipment in the offices that are involved (e.g., Common Channel Interoffice Signalling for ESS 4A offices). Also, there are other more sophisticated methods of interconnecting which might have to be considered by the specialized carrier. However, these are technical-operational problems which can be resolved to be compatible with the intraexchange-interexchange structure.

As noted earlier, the existing hierarchy requires traffic data to determine circuit quantities and facility arrangements. It is not unreasonable to expect that such data and planning can continue unimpeded within the proposed industry structure where, for example, both the operating company (intraexchange carrier) and the specialized carrier provide data for higher level toll switching and facilities as required. Similarly, such planning down through the hierarchy, with the local company, would occur with the long lines company and the specialized carrier. This information can be derived and resolved with those companies involved within the proposed structure in a manner similar to that now used for jointly owned facilities of existing telephone companies.

This overview of the current industry structure and operations appears to indicate the basis for compatibility with the proposed intraexchange-interexchange structure of operations. Where there are specific signalling, termination, and other interconnect or interface problems, they appear to be readily resolved in ways which are similar to those which now prevail. Moreover, where economic factors may impinge on local (intraexchange) companies, they may be offset by the local network access charges to be imposed equally upon all interexchange carriers with which the local companies interconnect. Alternatively, if any economic factors are evident on the interexchange side, they would appear to favor the existing network-system participants which would likely continue their current interconnecting arrangements with which the specialized carriers would have to interface.

A selected list of publications which relate to the issues discussed above, from technical, economic and institutional viewpoints, is attached to this review.

SELECTED PUBLICATIONS

Engineering and Operations in the Bell System, Bell Telephone Laboratories, Inc., 1977.

Notes on Distance Dialing, American Telephone & Telegraph Company Engineering and Network Services Department, 1975.

Basic Telephone Switching Systems, David Talley, Hayden Book Co., 1969.

Fundamental Principles of Switching Circuits and Systems, American Telephone & Telegraph Company.

"National Telephone Network Transmission Planning in the American Telephone & Telegraph Company," *IEEE Transactions on Communications Technology*, Vol. COM-19, No. 3, June, 1971.

The Dilemma of Telecommunications Policy; A Preliminary Inquiry into the State of Domestic Telecommunications by A Telecommunications Industry Task Force, 1978.

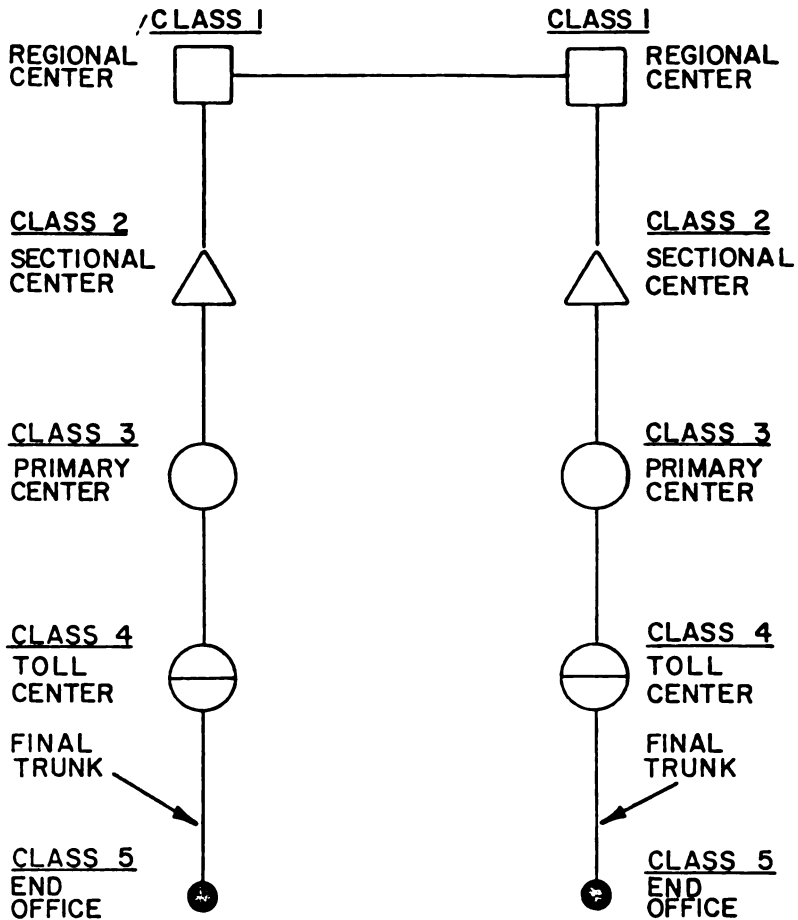
The Economics of Regulation: Principles and Institutions, Vols. I and II, Alfred E. Kahn, John Wiley & Sons, 1970 and 1971.

Computers and Telecommunications, S. L. Matheson and P. M. Walker, Prentice-Hall, 1970.

The Domestic Telecommunications Carrier Industry, Parts 1 and 2, Staff Papers, President's Task Force on Communications Policy, 1969.

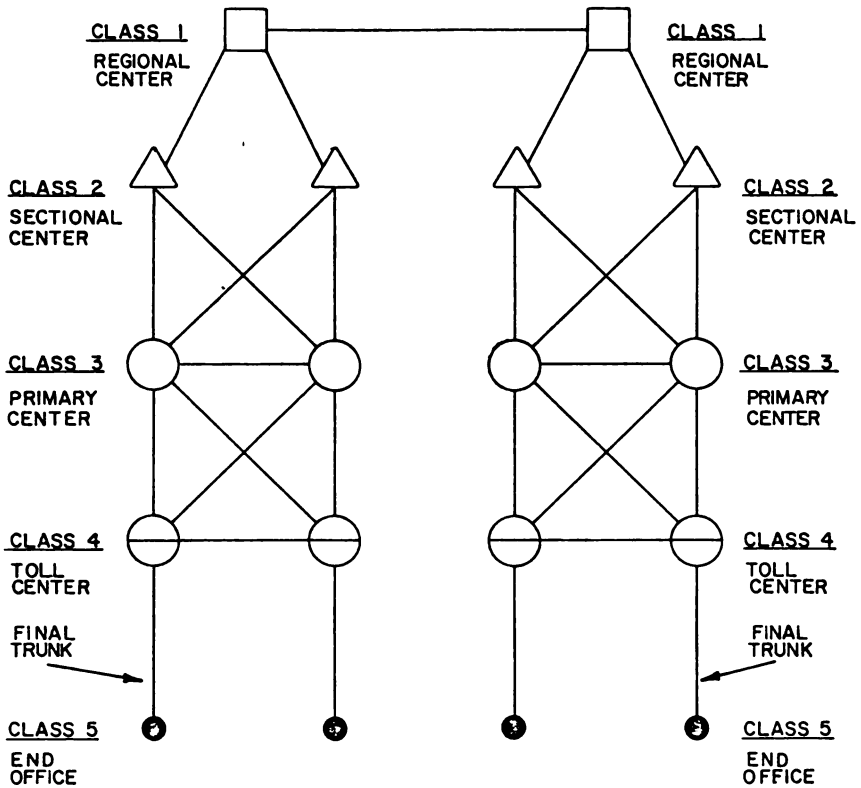
Transmission Systems For Communications, Revised 4th Edition, Bell Telephone Laboratories, 1971.

FIG. 1
BASIC TOLL NETWORK



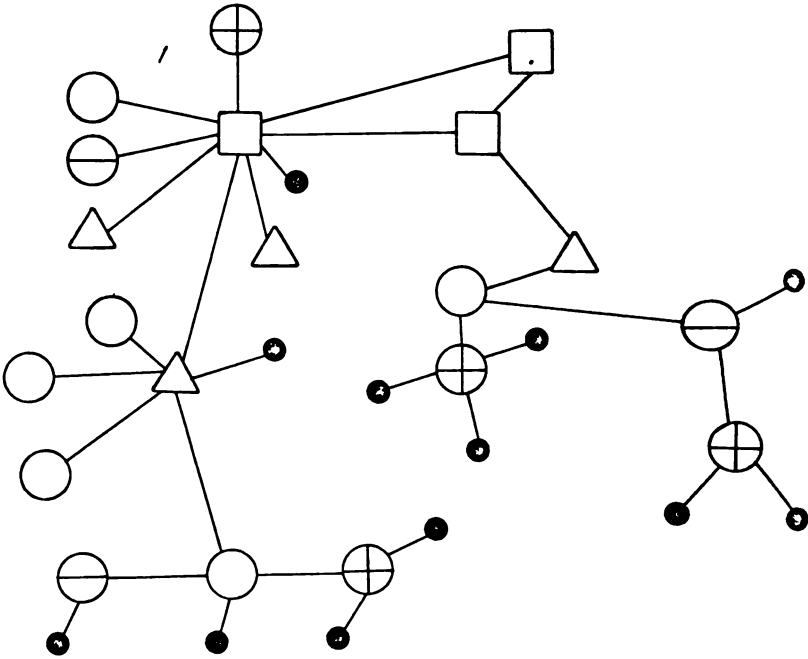
Source: Notes on Distance Dialing, 1975,
American Telephone & Telegraph Co.

FIG. 2
INTERCONNECTING AND ALTERNATE
ROUTING PATTERN



Source: Notes on Distance Dialing, 1975,
American Telephone & Telegraph Co.

FIG. 3
TYPICAL
SWITCHING PLAN



NOTE: TOLL POINT IS DEFINED AS
A LOCATION WHERE OPERATOR
ASSISTANCE IS PROVIDED ON
OUTWARD CALLS.

Source: Notes on Distance Dialing, 1975,
American Telephone & Telegraph Co.








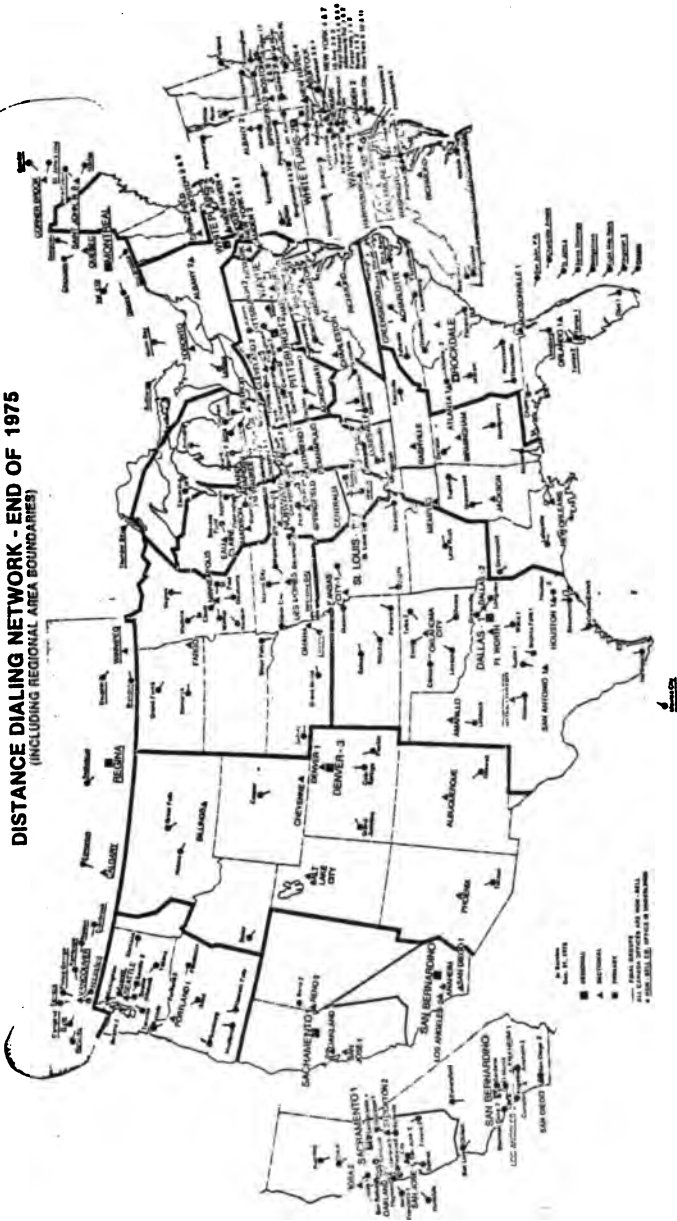
<u>SYMBOL</u>	<u>CLASS</u>	<u>NAME</u>
	1	REGIONAL CENTER
	2	SECTIONAL CENTER
	3	PRIMARY CENTER
	4C	TOLL CENTER
	4P	TOLL POINT
	5	END OFFICE
	FINAL	TRUNK GROUP

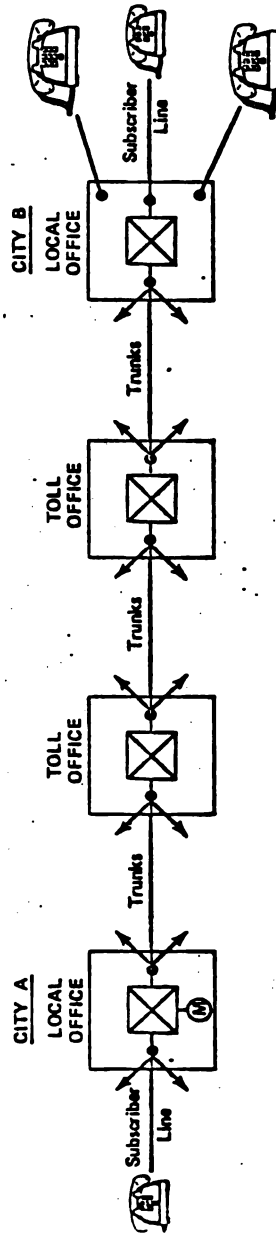
FIGURE 4
DISTANCE DIALING NETWORK - END OF 1975
 (INCLUDING REGIONAL AREA BOUNDARIES)



Source: AT&T Response JB-66
 FCC Docket 20981

FIGURE 5

MTS
| (MESSAGE TELECOMMUNICATIONS SERVICE)



Source: AT&T Letter to FCC
September 28, 1978

FIGURE 5

MTS - Typical Call

To initiate an interstate MTS call, the originating subscriber goes off-hook and receives dial tone from the serving local office. The subscriber then dials 10-digits, the 3-digit NPA* code and the 7-digit exchange telephone number of the called station.

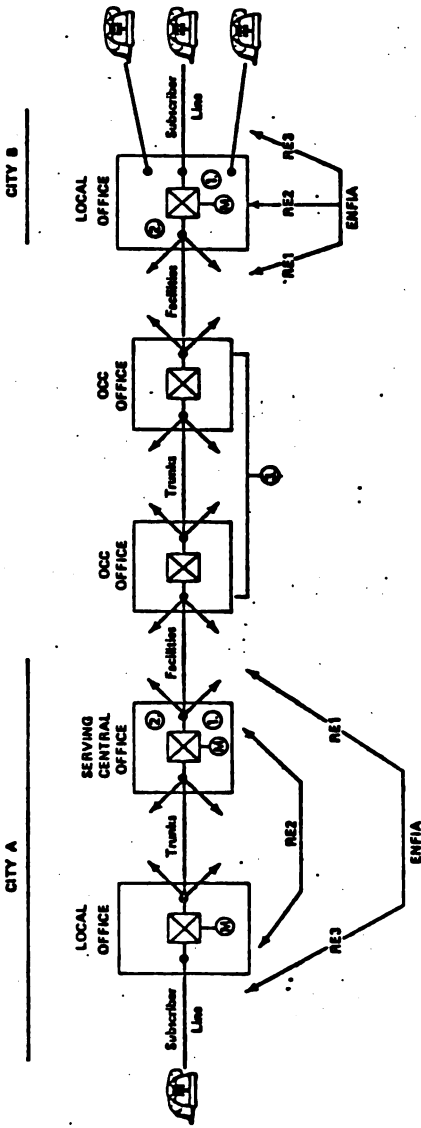
Upon receipt of those digits, the local central office recognizes this as a toll call, attaches Automatic Message Accounting (AMA) equipment, connects the subscriber line to a toll connecting trunk which is terminated in the toll switching machine located in the toll switching office, and forwards the 10 digits to that toll switching office.

The toll switching machine has the built-in intelligence to determine the proper public switched network route and connects the call to a trunk to the desired distant toll switching office. The 10 digits are then forwarded to the distant toll switcher. The distant toll switching machine absorbs the first three routing digits; connects to a toll completing trunk to the local office serving the called subscriber; and forwards the seven digits of the called telephone subscriber to the local office. (The number of digits forwarded to the local office could be 4, 5, 6 or 7 depending upon the particular central office equipment configuration, but is usually 7.)

The local serving office switch connects the toll completing trunk to the subscriber line, rings the subscriber if idle or returns a busy signal if the line is busy. Upon answer by the called party, a signal is returned to the originating local serving office to trigger the AMA equipment to begin timing .

*The local area code

EXECUNET AND SPRINT V



Source: AT&T Letter to FCC
September 28, 1978

FIGURE 6

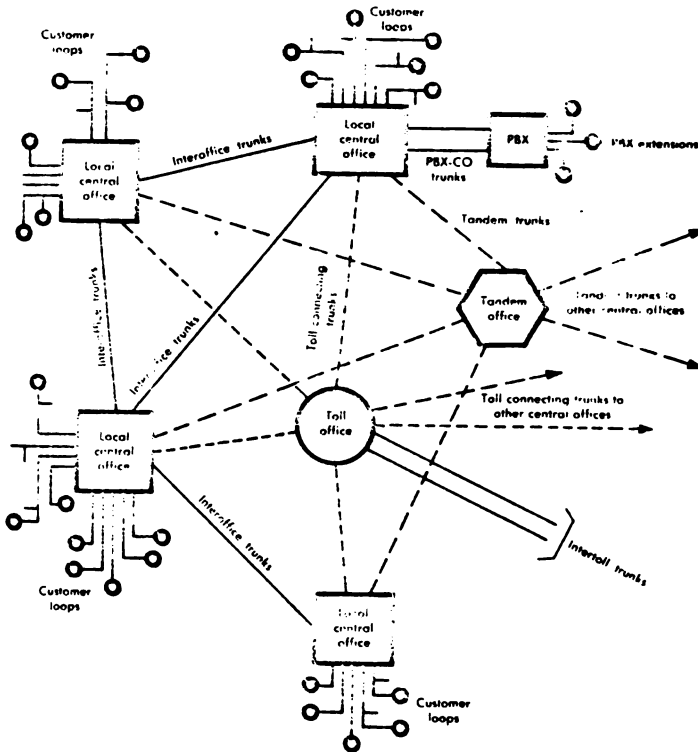
Execunet and Sprint V

The patron picks up his handset and receives dial tone from a local telephone office. He then dials the 7-digit telephone number of the exchange service subscribed to by the OCC.

The local office switches the call via an interoffice trunk in the public switched network to the Telephone Company's central office serving the OCC. A switch in that central office switches the call to the facilities going to the OCC office and delivers ringing current to the OCC office. The switch in the OCC office automatically answers the call, sends an off-hook signal to the patrons local office and returns a tone to the patron. At this point, the patron inputs an authorization code and the 10-digit number required to reach the desired distant telephone subscriber.

The OCC carries the call, including the dial information to its distant office. The OCC distant office connects to a Telephone Company provided facility to the Bell local office, and forwards an off-hook condition to the Bell office, receives dial tone and automatically delivers either 7 or 10 digits to the Bell local office. 7 digits will be delivered if the call is going to a number in that NPA* and 10 digits will be delivered if the call is going to a number in a different NPA. Based on those digits, the local telephone switch connects the call through the public switched network to the called telephone subscriber line, rings the subscriber if idle, or returns busy signal if the line is busy.

FIGURE 7
Exchange Area Plant



Source: Transmission Systems for Communications, p. 75,
Bell Telephone Laboratories.

The CHAIRMAN. Thank you very much.

Next we will hear from Mr. Whitney.

Mr. WHITNEY. Thank you, Mr. Chairman, and members of the subcommittee.

I am L. C. Whitney, president and chief executive officer of National Data Corp.

I am testifying on behalf of the Computer and Communications Industry Association—CCIA—of which our company is a member.

With me is Philip S. Nyborg, vice president and general counsel for CCIA, and George M. Shea, vice president and general counsel of National Data Corp.

CCIA is a trade association representing member companies which provide services and products in the data processing and data communications markets. Our products and services include computers, communications, and terminal equipment, software remote access computer services, and data communications services.

Our members' annual revenues range from \$1 million to \$400 million, with an average revenue of approximately \$50 million. Collectively, they represent annual revenues in excess of \$3.5 billion and employ over 100,000 persons.

National Data Corp. is a publicly owned computer service company. We operate a nationwide real-time information processing system utilizing all the principal services currently offered by A.T. & T. Our systems provide health care services, cash management services, credit card authorization services, and consumer telephone ordering services. Our customers include over 150 banks and 2,000 major corporations. We are a major user of business telephone services, utilizing at any one time over 300 WATS lines.

Our services will be directly affected by the proposed competition among common carriers.

Our company and other companies in CCIA are concerned about the entry of any common carriers into these markets, either as a provider of service or as an equipment manufacturer, when they are today the monopoly power in communications markets and communications services on which data processing service companies are totally dependent.

My testimony today is directed toward title II of S. 611 as it relates to domestic telecommunications.

The concerns shared by CCIA and National Data are the same ones voiced last year at the hearings on H.R. 13015, and which are recognized in S. 611. They are: one, the subsidization of competitive offerings by monopoly communications revenues; two, the denial of competitor access to monopoly communications facilities; and three, the inability under present laws to prevent these and other unfair practices in competition by monopoly or dominant carriers.

The full text of my statement is on file with your committee staff. I have included also two appendices which address (a) proposed specific amendments to the bill, and (b) the historical problems faced by the FCC with practices of cross-subsidy and denial of access. We will submit an exhibit on the inadequacies of present and contemplated accounting controls and separation.

The principles of separation and access embodied in the bill are necessary and appropriate in view of the history of competitive

communications. In spite of past antitrust action against A.T. & T. that resulted in the 1956 consent decree, and in spite of regulatory decisions subsequent to 1956 detailing instances of A.T. & T.'s actual or potential anticompetitive practices, cross-subsidy continues to be both a pervasive practice and a frequent FCC issue.

With respect to denial of access, the FCC issued a broad directive to all telephone carriers to make available local distribution facilities to competitors on a reasonable and nondiscriminatory basis.

Nonetheless, A.T. & T. today is the defendant in at least four separate lawsuits, all of which allege denial of equitable competitor access to A.T. & T. facilities and violation of the antitrust laws.

Competitive issues relating to monopoly carriers have evolved beyond the communications industry itself, for monopoly carriers have already begun to cross the boundary into the competitive marketplace for data processing equipment and services. The fundamental issue now is the relationship between monopoly communications services on the one hand, and all competitive offerings—equipment or services—on the other.

With respect to A.T. & T., there is a further issue: whether the 1956 antitrust consent decree, restricting A.T. & T. to communications offerings, should be overridden so as to permit A.T. & T. to enter into data processing.

The communications issues of cross-subsidy and denial of access will be equally important in the information services and electronic equipment areas if A.T. & T. is permitted to offer such services and products without adequate safeguards.

For example, A.T. & T. presently is licensing through Western Electric, noncommunications computer software that was developed at Bell Laboratories. Bell Laboratories, however, is funded by assessments on the Bell operating companies, which, in turn, are funded by telephone ratepayers.

The development of this software at Bell Laboratories thus is subsidized by monopoly telephone revenues, and the dollars come from the ratepayers' pockets.

In addition, A.T. & T. asked the FCC for authority to provide its advanced communications service—ACS—which has been universally recognized by the computer industry as a substantial data processing offering. A.T. & T. has already stated that ACS competitors may not have equitable access to the DDS facilities over which ACS will be offered.

Anticompetitive practices are being addressed in this pending legislation, and Congress has a spectrum of available remedies for dealing with these problems of cross-subsidy and denial of access.

The remedies range from divestiture of competitive offerings, to "full separation" of competitive offerings in a separate subsidiary or other corporation related by ownership, down to "accounting separation" of monopoly and competitive offerings within the same corporation.

It is CCIA's position that divestiture of competitive components is the only solution that eliminates the incentive for a monopoly carrier to cross-subsidize or deny access. We feel that this remedy should be adopted in S. 611.

Instead, the separate subsidiary or full separation approach is partially embraced by S. 611, but in key areas such as competitive

communications and computer equipment manufacturing and computer services, the bill permits the FCC to shift to what we believe to be the least effective alternative, accounting separation.

Methods of cost allocation are numerous and often subjective.

Complaints have been lodged by several parties about A.T. & T.'s improper application of the new fully distributed costing methodology mandated by the FCC.

Our conclusion is that an attempt at separation by accounting will only increase rather than decrease regulatory oversight, and this clearly is contrary to the purpose of the bill.

On the other hand, full corporate separation permits monitoring of the relationship between monopoly and competitive offerings on a broader level and, therefore, cost allocation becomes a moot issue if products or services offered between the monopoly carriers and its competitive affiliate were available to all competitors on precisely the same terms.

We recognize that this bill seeks ultimately to have fair competition be the regulator in the communications marketplace, and we strongly support this objective.

When a monopoly carrier is subject to effective and fair competition in all of its services, it will lack a monopoly base from which to subsidize.

Restrictions are necessary unless and until such effective and fair competition exists.

These restrictions must be written in such a manner that competitors and users of the services have standing to bring effective enforcement actions against a violator.

This is especially necessary in light of the fact that this bill permits A.T. & T. to enter the data processing market by nullifying an antitrust consent decree which was written to restrict A.T. & T.'s anticompetitive behavior.

We recommend two areas of change in S. 611 that would permit effective implementation of the principles that this legislation sets forth.

First, we ask that full separation between monopoly communications carriers and any of their competitive offerings be required in all situations.

The bill should include a statutory mandate for full corporate separation, and the Commission should not be granted an option to use the totally unacceptable method of accounting separation.

At present, the bill recognizes that the problems of cross-subsidy and denial of access, as they relate to communications services, require a full separation.

The bill implies, however, that monopoly communication services need not be fully separated from equipment manufacturers and data processing service organizations. We feel that this is a major inconsistency.

Second, we ask that the principle of full separation be further articulated and effectively implemented to provide:

One: That a dominant carrier shall not make any directly competitive offerings.

Two: That a separate corporate affiliate of a dominant carrier may make any competitive offering and it may lease or resell communications services of its dominant carrier provided, however,

the dominant carrier must make such services available to all competitors under the same terms and conditions.

Three: That a dominant carrier and its competitive affiliate may not favor each other as supplier or customer.

Four: The investment by a dominant carrier in its competitive affiliate must be on a basis that avoids cross-subsidization. This arm's length investment requirement is a key element of our proposal. CCIA recognizes, however, that it would be inherently difficult for the FCC to monitor. Therefore, we further propose that a substantial minority portion of the securities of any competitive affiliate or a dominant carrier be publicly held. This proposal contemplates that the financial marketplace would assist the Commission in preventing abuses by insuring that investments reflect generally prevailing commercial conditions, and, second, that the financial reports required by the Securities and Exchange Commission to be filed by publicly held companies would substantially assist the FCC, as well as investors, in determining if investments were on a true arm's length basis.

Five: That there be no joint marketing or tying of a monopoly communications service to a competitive service or product between the dominant carrier and its competitive affiliate, and there must be separate billing for services.

Six: The results of any research and development that has been funded directly or indirectly by the dominant carrier must be made available on equal terms to all parties.

These proposals for full corporate separation are not intended to be all inclusive, and CCIA would welcome the ideas of other parties in order to better implement this objective.

Again, we view full corporation separation as an alternative remedy, to be utilized only in the event that the final version of this bill ultimately rejects divestiture.

However, if full separation is retained, and if our proposals relating thereto are adopted, then CCIA, and, we believe the industry as a whole, would be in a position to strongly support this legislation as a major and positive milestone in the evolution of our country's information and communications policy.

CCIA and NDC stand ready to offer any assistance you may desire in clarifying or amplifying the details of our proposal.

Thank you for permitting me to speak to you today on behalf of the Computer and Communications Industry Association.

Thank you.

[The statement follows:]

STATEMENT OF L. C. WHITNEY, PRESIDENT OF NATIONAL DATA CORP., ON BEHALF
OF COMPUTER & COMMUNICATIONS INDUSTRY ASSOCIATION

Mr. Chairman and Members of the Subcommittee: I am L. C. Whitney, President of National Data Corporation. I am testifying on behalf of the Computer & Communications Industry Association ("CCIA"), of which my company is a member.

CCIA is a trade association representing 69 member companies which compete in the data processing and data communications markets. Their products and services cover a broad spectrum and, particularly relevant to these hearings, include main-frame computers, communications equipment, data terminal equipment, computer software, remote access computer services, and data communications services. Our members range in size from annual revenues under \$1 million to in excess of \$400 million, while an average member has revenues of approximately \$50 million. Collectively, they represent annual revenues in excess of \$3.5 billion and employ over 100 thousand persons.

National Data Corporation is a publicly owned data service company based in Atlanta, Georgia. We operate a nationwide real time information processing system accessed by AT&T's Inward Wide Area Telephone Service (WATS). Our 24-hour a day system is used for cash management, credit card authorization and check verification services, management information reporting services, and consumer telephone ordering services. Our customers include over 150 banks and 2,000 major corporations. National Data is a major user of business telephone services, utilizing at any one time over 300 WATS lines, which services will be directly affected by the proposed competition among common carriers. National Data and CCIA view with concern the entry of dominant communications common carriers into the heretofore proscribed area of data processing (either as providers of services or as equipment manufacturers), when, as often is the case, these carriers are both monopoly powers in communications markets and the providers of communications service upon which data processing service companies are totally dependent.

My testimony is directed toward Title II of S. 611 as it relates to domestic telecommunications. I will address issues and problems relating to participation by monopoly communications carriers in both competitive communications and data processing markets, whether as a provider of service or as an equipment manufacturer.

The fundamental concerns shared by CCIA and National Data that I will discuss today are the same ones voiced last year at the hearings on H.R. 13015, and which are recognized in Senate Bill S. 611. They are: (1) the subsidization of competitive offerings by monopoly communications revenues; (2) the denial of competitor access to monopoly communications facilities; and (3) the inability under present laws to prevent these and other unfair practices in competition by monopoly or dominant market carriers. I will focus on these issues in the context of S. 611, with amplification of our discussion being reserved for two appendices attached to this Statement, which address (a) proposed specific amendatory language to the Bill, and (b) the historical problems faced by the FCC with practices of cross-subsidy and denial of access.

Throughout the following discussion, section references are to sections of the Bill rather than to the Communications Act, unless otherwise specifically indicated.

Sections 207 and 205 of the Bill address the problem of cross-subsidy and, in essence, propose "full separation" between various monopoly services and competitive offerings, as well as full separation between non-competitive exchange service and any interexchange service. Section 209 deals with denial of competitor access by requiring that every non-competitive exchange, or interexchange (or international) service not subject to effective competition shall establish physical connections with any other carrier upon request. Section 210 further requires non-competitive interexchange services to be provided on non-discriminatory terms upon reasonable request.

These principles are necessary and appropriate in view of the history of competitive communications, wherein the issues of cross-subsidy and denial of access have been pervasive in FCC regulation. For despite past antitrust action against AT&T that resulted in the 1956 Consent Decree, and despite a plethora of regulatory decisions subsequent to 1956 detailing instances of its actual or potential anticompetitive practices, cross-subsidy continues to be pervasive in FCC rate regulation proceedings with respect to services in which AT&T faces competition. Recent examples of these problems are brought to mind by the FCC proceedings involving Telpak, the 7-Way Cost Study, and private line tariffs (Hi-Lo and Multi-schedule Private Line ("MPL")). The recent decision of Judge Miller in phase I of Docket 20814 (MPL tariff), rejects AT&T's multi-schedule private line tariff and reviews with obvious frustration the Commission's inability to compel AT&T to set cost-justified rates for either private line services or DDS (data) service, both key competitive services. (For the Subcommittee's reference, Judge Miller's decision is attached as Exhibit 1.)

With respect to denial of access, AT&T already is under a statutory obligation, after Commission order, to establish physical connections with other carriers (Communications Act, Section 201) and to refrain from discrimination in charges or practices (Communications Act, Section 202). The Commission in 1971, recognized in its *Specialized Common Carrier Decision* that AT&T would have a serious incentive to discriminate against competing private carriers, and issued a broad directive to all telephone carriers to make local distribution facilities available to competitors on a reasonable and non-discriminatory basis. Nonetheless, AT&T is today the defendant in at least four separate lawsuits brought by Datran, MCI Telecommunications Corporation, Southern Pacific Communications, and the U.S. Government, each of which alleges denial of equitable competitor access to AT&T facilities and violation of the antitrust laws.

Anticompetitive problems in the communications industry also encompass communications equipment manufacturing and the activities of the manufacturing subsidiaries of carriers such as AT&T and GTE. The activities of AT&T's Western Electric are well documented in the proceedings leading up to the 1956 Consent Decree, and today are again the subject of a Department of Justice antitrust suit against AT&T. However, competitive issues relating to monopoly carriers have evolved beyond the communications industry itself, for monopoly carriers have already begun to cross the boundary into the competitive marketplace for data processing equipment and services. The fundamental issue now is the relationship between monopoly communications services on the one hand, and competitive offerings on the other (e.g., communications equipment, competitive communications services, data processing equipment, and data processing services).

With respect to AT&T, however, there is a further issue: whether the 1956 antitrust Consent Decree, restricting AT&T to communications offerings, should be modified or abrogated to permit the carrier's entry into areas not involving common carriage such as data processing. In this regard, it would appear that history may well forecast the future: that the problems of cross-subsidy and denial of access, which have been so pervasive in competitive communications will, if AT&T is permitted to offer such services and products without adequate safeguards, be equally pervasive in the information service and electronic equipment markets. For example, AT&T is, through Western Electric, presently licensing computer software (i.e., selling it in the data processing marketplace) that was developed at Bell Laboratories; Bell Laboratories, however, is funded by general service and license fees that are assessed on the Bell operating companies which, in turn, are funded by telephone ratepayers. The manufacture of this software at Bell Laboratories is thus subsidized by monopoly telephone revenues, and the dollars come from the ratepayers' pockets.

In addition, AT&T has petitioned the FCC for authority to provide its Advanced Communications Service (ACS), which has been universally recognized by the computer industry as a substantial data processing offering. However, AT&T already is on record as having stated that competitors of ACS service may not have equitable access to the DDS facilities over which ACS will be offered, nor will they necessarily pay the same price for the use of those facilities.

These anticompetitive practices, admirably, are being addressed in this pending legislation. Congress has a spectrum of available remedies for dealing with these problems of cross-subsidy and denial of access. If we conceptualize carriers as offering basically two categories of services or products—monopoly and competitive—the remedial spectrum ranges from: Divestiture of competitive offerings, to “full separation” of competitive offerings in a separate subsidiary or other corporation related by ownership, down to “accounting separation” of monopoly and competitive offerings within the same corporation.

Last year, in testimony before the House Communications Subcommittee on H.R. 13015, the Communications Act of 1978, CCLA reached and supported the conclusion that only divestiture of competitive offerings from monopoly carriers would achieve fully competitive conditions in the competitive communications and computer industries. It was proposed that monopoly exchange carriers divest, or be divested from, all components of their business that offer products or services in markets subject to competition (whether effective competition or not), such as equipment manufacturing and intercity transmission. Because such divestiture severs only corporate ownership relations (which create the incentives for cross-subsidy and denial of access), legitimate service relationships between such carriers and the divested components would remain intact. The system would deviate from its present structure only to the extent that competitive alternatives to AT&T Long Lines or Western Electric were more attractive from the standpoint of price or performance.

It is CCLA's position that divestiture of competitive components is the only solution that eliminates the incentive for a monopoly carrier to cross-subsidize or deny access. However, this remedy has not been adopted in S. 611. Instead, the “separate subsidiary” or “full separation” approach is partially embraced by S. 611, but in certain key areas, such as communications and data processing equipment manufacturing and the provision of data or information processing services, the Bill grants the FCC discretion to shift to the third (and least effective) alternative, accounting separation.

There are significant differences between corporate separation and accounting separation with respect to preventing cross-subsidy and denial of access. Enforcement of accounting separation requires access to accurate cost information which is extremely difficult, if not impossible, to obtain from a reluctant carrier. Often, cost allocations must be made between monopoly and competitive services; and example of this is the allocation of costs between public switched telephone service (MTS,

WATS) and DDS (or data) Services, all of which use the same public switched network and facilities, albeit in differing degrees. Even if the FCC could obtain extensive information on operations and charges, any proceeding wherein such charges or costs were examined would continue to be plagued by the question of proper cost allocation that has chronically hindered rate regulation with respect to such tariffs as MPL, and DDS, as well as to MTS/WATS.

Moreover, accounting separation requires both the regulatory authority and competitors to monitor carrier activities on a "micro" level, effectively requiring them to implement a continuous audit of all carrier accounting and management decisions relating to allocation of costs. As stated above, A.T. & T. presently allocates its costs between MTS/WATS and DDS, which utilize the same facilities. Methods of cost allocation are numerous, and often subjective, and the FCC has expended countless hours in the course of several proceedings to develop and adopt a satisfactory costing methodology. Even after the Commission's adoption of fully distributed cost method 7, which was intended to resolve the cost allocation problem, other parties have continued to lodge complaints to the effect that A.T. & T. has not properly applied the new costing methodology. All of this points to the conclusion that any attempt at separation by accounting will only increase, rather than decrease, regulatory oversight. This result is clearly contrary to the purpose of the Bill.

A separate subsidiary or maximum separation approach, i.e., corporate separation, on the other hand, permits monitoring of the relationship between monopoly and competitive services on a broader level, allowing the Commission and competitors to scrutinize transactions between the monopoly and competitive companies, the flow of investment from the monopoly to the competitive subsidiary, and other exchanges, such as the exchange of research and development information, between parent and subsidiary which may, or may not, be for reasonable value. Proper cost allocation could become a moot issue if products or services offered between a monopoly carrier and its competitive affiliates were available to all competitors on precisely the same terms.

Even if a separate subsidiary or maximum separation approach is taken, however, there remain other problems which would require careful monitoring. These include marketing (competitive firm leveraging from the monopoly's customer base, or a product and service tying arrangement) and a preferred supplier/customer relationship, the latter of which is at issue in the Justice Department's present and preceding antitrust litigation against A.T. & T. and Western Electric. In addition, a monopoly carrier and its competitive affiliate will always have a mutual interest in the success of the other, and will have a strong financial incentive to favor each other over outside competitors, even when separated. It also should be noted that even with "full separation" defined as it is in S. 611, a monopoly will continue to have an ownership relationship with its competitive affiliates, which obviously equates to control. This control will exist as long as there is a majority or greater ownership relationship.

We recognize that this Bill seeks ultimately to have competition be the regulator of the communications marketplace and we strongly support this objective. When a monopoly carrier is subject to effective competition in all of its services, it will lack a monopoly base from which to subsidize. The key, however, is in the word "effective," and restrictions are necessary unless and until such effective competition exists. We believe that such competition does not now exist with respect to A.T. & T. in intercity (long haul) transmission, or with respect to A.T. & T. and other carriers in local distribution.

We recognize also that many view "A.T. & T. v. IBM" as a competitive scenario and solution to the serious structural problems and economic concentration that exists in the industries represented by these two companies. There is no assurance, however, that these two industry giants would not share the computer/communications markets and constitute the "tight oligopoly" or "shared monopoly" about which the Justice Department, the Federal Trade Commission, and related congressional committees share concern. IBM's relative strength (partially through SBS) is in serving the data processing and data communications needs of major companies, while A.T. & T. is, relatively speaking, oriented more toward the needs of smaller businesses and, ultimately, residential users of data services. The common submarkets, i.e., areas of actual competition addressed by both A.T. & T. and IBM, at the present time include only data terminal equipment and private line services (the latter through SBS, which service is not yet operational); these represent a very minor amount of each company's total revenues.

This Bill represents a major change in the policy *status quo*, because it would permit A.T. & T. to enter the data processing market. Further, it does so by nullifying an antitrust consent decree written to restrict anticompetitive behavior

on the part of A.T. & T. Herein lies one of our major concerns. Even with the Consent Decree in effect, there has been an established history of anticompetitive practices by A.T. & T. in communications markets. How then does this Subcommittee conclude that lifting the decree—when it would permit the extension of such anticompetitive practices into non-communications markets such as data processing—is a pro-competitive action?

We submit that enforceable and effective *restrictions* are necessary until such time as true competition becomes a reality and these restrictions must be written in such a manner that competitors and users of the services have standing to bring enforcement actions against a violator. The restrictions proposed by CCIA today are not permanent measures, but are intended to remain in place for so long as any monopoly or Category II carrier, or any part of its corporate family, is not subject to effective competition. If and when true competition does emerge in the communications industry, the restrictions can be removed.

We seek two areas of change in S. 611. In our view, these changes are entirely in consonance with the intent and philosophy of the Bill. They would permit effective implementation of the principles that this legislation sets forth. If these changes are adopted (and, of course, the principles of Section 205 and 207 remain in the Bill without degradation due to changes in other sections), CCIA would be in a position to strongly support this legislation as a major and positive milestone in the evolution of our country's information and communications policy.

First, we ask that "full separation" between monopoly communications services and any competitive offering be mandated in all situations. The provisions of Section 205 of the Bill relating to communications and electronic equipment and information software and services should include a statutory mandate for full corporate separation rather than providing the Commission the option to use the unsatisfactory method of accounting separation. This change would give the full separation requirements of Section 205 the same force and effect as the "full separation" requirements of Section 207 of the Bill relating to communications services.

At present, the Bill would appear to have a major inconsistency in recognizing that the problem of cross-subsidy and denial of access, as they relate to communications services, requires a "full separation" solution, while at the same time leaving the implication that separation between dominant or monopoly communication services and other competitive offerings (communications equipment, data processing equipment, data processing services) is not required.

Specifically, Section 207 of the Bill presently requires full separation between non-competitive exchange carriers and interexchange carriers as well as between Category II interexchange public message telephone carriers and other interexchange services, but Section 205 does not.

The change we suggest for Section 205 of the Bill would require the same separation between Category II carriers and non-competitive exchange carriers on the one hand, and providers of telecommunications equipment, electronics equipment, information software and information service on the other.

The rationale for this change, we believe, already has been embraced with respect to communications services in Section 207 of the Bill, which appears to conclude that mere accounting separation is not adequate with respect to certain categories of communications services. We hold the same view with respect to communications services not subject to effective competition on the one hand, and equipment manufacturing and data processing services on the other. Accounting separation simply is not adequate to prevent the anticompetitive abuses of cross-subsidy and denial of access and it fosters more, not less, regulatory oversight.

Consistent with the general separation principle we have proposed, the separation requirements of Section 207 (Section 205(d) of the Communications Act, as amended) should be extended to exchange carriers as well. That is, any exchange carrier that provides public message telephone service not subject to effective competition must provide any competitive offering (whether equipment or service) only through a fully separated entity.

The second change we seek is that the principle of "full separation" be further articulated and effectively implemented. We propose the following parameters for "full separation" with respect to monopoly carriers (that is, Category II carriers and exchange carriers not subject to effective competition) on the one hand, and any competitive affiliate (that is, any provider of communications equipment, competitive communications service, electronics equipment, information software or information services) on the other. (For ease of reference, reference is made simply to "competitive affiliates," which could encompass one or more of these competitive offerings, and to "monopoly carriers," which could include a Category II or a non-competitive exchange carrier.)

At the very least the Bill should provide that "full separation" means:

1. No monopoly carrier shall make any competitive offering of a service which is subject to effective competition.

2. A competitive affiliate of a monopoly carrier may make any competitive offering. It may lease and resell communications services of its monopoly affiliate. (For example, a competitive affiliate of AT&T could provide DDS, ACS, or a data processing service based on circuits leased from AT&T Long Lines as the Category II carrier. Western, and other competitive affiliates could manufacture and sell or lease any kind of equipment.) However, the monopoly carrier must make such underlying services available to any unaffiliated competitor under the same terms and conditions.

3. A monopoly carrier and its competitive affiliate may not favor each other as supplier or customer.

4. There may be no joint marketing or tying of a monopoly communications service to a competitive service or product between the monopoly carrier and its competitive affiliate, and there must be separate billing for services. Monopoly carriers must be precluded from billing its customers directly for its competitive affiliates' services.

5. The results of any research and development that has been funded, directly or indirectly, by the monopoly carrier must be made available to all competitors seeking access to such information on the same terms and conditions that it is available to the monopoly carrier's competitive affiliate.

6. The investment of equity or debt capital by a monopoly carrier in its competitive affiliate must be on a basis that generally reflects marketplace conditions—the conditions under which non-affiliated competitive companies obtain their capital—so that this investment of equity or debt does not represent a subsidy from the monopoly carrier to its competitive affiliate.

This list is not all inclusive and CCIA believes there may be other requirements that will need to be met in ensuring "full separation." Having outlined some of the requirements of full separation, let us look briefly to the requirement of arms-length investment, which is a key element of our proposal. As noted, the intent here is that a fully separated entity not obtain financing from the monopoly carrier on terms and conditions more advantageous than would generally be available from prudent unaffiliated investors. CCIA recognizes, however, that it would be inherently difficult for the FCC to determine whether such financing met these conditions. Therefore, we further propose that a substantial portion, i.e., one third, of the securities of any fully separated entity of a monopoly carrier be publicly held.

This proposal contemplates first, that the securities and banking marketplace would aid the Commission in determining whether such equity or debt investment reflected generally prevailing investment conditions; and second, that the financial reports required by federal securities laws to be filed by publicly held companies would substantially assist the FCC in determining whether investment were on a truly arms-length basis. It is fully intended that the minority public ownership requirement proposed by CCIA invoke SEC requirements for disclosure of transactions between related companies.

Beyond the investment issue itself, however, this approach would substantially help to insure that the entire relationship between fully separated entities or carriers were on a true arms-length basis. For example, a subsidiary publicly held in this proportion would file corporate income tax returns with the IRS, as well as the full range of SEC reports required for publicly held companies, all of which would be available to the FCC to assist in monitoring the arms-length relationship. The public investors would act as a further "check and balance" on the relationship between the fully separated entity or carrier in which they hold shares and the related monopoly carrier. In addition, shareholders of the monopoly carrier would have a new interest in scrutinizing cross-subsidy to a competitive affiliate which was not a wholly owned subsidiary. In all cases, shareholders and the FCC would have the benefit of the reports filed by publicly held companies in their efforts to scrutinize related company transactions that might adversely affect their interests.

Monopoly carriers could retain control of fully separated entities or carriers, but would be subject to scrutiny with respect to any illegal or improper financial transactions. There is statutory precedent for such a public ownership requirement in the Communications Satellite Act of 1962, which requires 50% public ownership of the Communications Satellite Corporation (COMSAT). Further, the FCC itself has established ownership restrictions with respect to competitive carriers, such as Satellite Business Systems, wherein it restricted the ownership share of partners such as COMSAT General and IBM to 49 percent.

Notwithstanding our proposal today, I would emphasize that divestiture remains the most effective form of full separation and CCIA maintains its strong support of

that remedy. Our proposal here is intended as an alternative should you reject the more straightforward divestiture approach.

With respect to other areas of the Bill, I wish to add that CCIA strongly supports the "standards provisions" of S. 611, and believes them to be an important and integral part of the scheme implemented by the Bill. Such standards will help to insure that both Category I and II carriers do not discriminate against competing offerings of terminal equipment (such as data terminals, computers, and PBX's), that can be interconnected to their services, and that Category II carriers cannot manipulate their de facto interconnect standards for anticompetitive purposes.

CCIA stands ready to offer any assistance you may desire in clarifying or amplifying the details of its proposal. Thank you for permitting me to speak to you today on behalf of the Computer and Communications Industry Association.

APPENDIX A

CCIA proposed amendment 1a

This amendment makes the full separation approach of Section 205 of the Bill mandatory, rather than a mere presumption which can be overridden by the FCC, and Section 205 of the Bill consistent with Section 207, which presently *requires* full separation between certain monopoly and competitive *communications services*.

This amendment to Section 205 would adopt the same approach (as that of Section 207) with respect to required separation between Category II carriers and non-competitive exchange carriers on the one hand, and *other* competitive offerings of such carriers on the other: telecommunications equipment, electronics equipment, information software and information services. Specifically, it would deal with the problem of cross-subsidy between monopoly and competitive offerings in the same way, by *requiring* that any such competitive offerings be made through a fully separated entity.

Pages 22 and 23 should be modified as follows:

Page 22

"(b)(1) No carrier classified as a Category II carrier under section 204, and no carrier which provides an exchange telecommunications service for which such carrier is not subject to effective competition, shall sell, lease, or otherwise market any telecommunications equipment or electronics equipment, information software, or information service, except through a fully separated entity. [, unless the Commission determines after hearing that conditions for effective competition in the relevant market or markets, and the interests of telecommunications service consumers, can be adequately protected through appropriate accounting or structural safeguards prescribed under section 205(b)].

"(2) Any carrier classified as a Category II carrier under section 204, and any carrier which provides an exchange telecommunications service for which such carrier is not subject to effective competition, shall be fully separated from any affiliated entity which produces or provides any telecommunications equipment or electronics equipment, information software, or information service. [, unless the Commission determines after hearing that conditions for effective competition in the relevant market or markets, and the interests of telecommunications service consumers, can be adequately protected through appropriate accounting or structural safeguards prescribed under section 205(b)].

CCIA proposed amendment 1b

Section 205 of the Bill presently creates a presumption, which can be overridden by the FCC, that there shall be full separation between Category II carriers or non-competitive exchange carriers, and affiliated entities making other competitive offerings: telecommunications equipment, electronics equipment, information software and information services.

If CCIA Proposed Amendment "1a" is adopted, this separation between non-competitive communications offerings on the one hand, and the enumerated competitive offerings on the other, would be mandatory.

However, even if so amended, Section 205 fails to deal with full separation between non-competitive exchange carriers and *competitive communications services* other than those competitive interexchange services addressed in Section 207 of the Bill. A non-competitive exchange carrier (e.g., a Bell Operating Company) could offer, for example, an *intraexchange* (i.e., exchange) electronic message service (EMS) in a major metropolitan area; EMS is, at present, a competitive communications service. Further, and equally important, if it offered an exchange version of a service such as AT&T's proposed Advanced Communications Service (ACS), it could attempt to *directly* provide a very substantial embedded data processing service. If

an operating company were required to offer "data processing" services through a fully separated entity, but could provide competitive "communications" services (and AT&T alleges ACS to be such a service) directly, it would have a strong incentive to declare all such services "communications."

A full separation approach to exchange telecommunications services would be a significant incentive to competition in the development of innovative local distribution or exchange services. This issue, like the terminal interconnect issue and the FCC Registration Program, is too crucial to be left to piecemeal resolution by State regulatory bodies.

CCIA, therefore, proposes that S. 611 include a requirement of full separation between non-competitive exchange carriers and competitive exchange telecommunications services.

The required separation should be modeled after the similar requirements for interexchange carriers stated in Section 207 of the Bill at page 31, lines 21 through 25 and page 32, lines 1 through 5. However, since requirements relating to exchange carriers are listed together in Section 226 of the Bill at page 60 lines 1 through 1b, the proposed full separation requirements would best be stated in the latter section.

Therefore, CCIA proposes that the new Section 231 which S. 611 adds to the Communications Act of 1934 be provided with a new subsection, and the existing subsections renumbered accordingly.

The following language should be inserted after line 1 on page 60 as the initial subsection of "COMMISSION REQUIREMENTS OF EXCHANGE CARRIERS."

Sec. 231. (a) Effective 180 days from the enactment of the Communications Act Amendments of 1979, no carrier which provides an exchange public message telephone service or services for which such carrier is not subject to effective competition shall also provide any other exchange service: *Provided, however,* That any such exchange carrier may provide, through non-discriminatory lease or tariff arrangements, exchange facilities or services to either fully separated carriers or to non-affiliated carriers for their use in providing such other exchange service.

CCIA proposed amendment 1c

S. 611 presently states "full separation" requirements in Section 205 (page 22, lines 9 through 25, and page 23, lines 1 through 7) and Section 207 (page 31, lines 12 through 25, and page 32, lines 1 through 20). Further, if, as suggested in CCIA Proposed Amendment "1b" and "full separation" requirement were imposed on the competitive communications offerings of a non-competitive exchange carrier, it would logically be stated in Section 226 of the Bill (page 60, lines 1 through 16).

CCIA Proposed Amendment "1a" would require full separation between Category II carriers and non-competitive exchange carriers on the one hand, and the following competitive offerings on the other: telecommunications equipment, electronics equipment, information software and information services. Section 207 of the Bill presently requires full separation, first, between Category II carriers providing non-competitive exchange service and the provision of any interexchange service; and second, between Category II carriers providing interexchange public message telephone service and any other interexchange service. CCIA Proposed Amendment "1b" would require similar separation between non-competitive exchange carriers providing exchange public message telephone service, and the provision of competitive exchange services.

All of these full separation requirements embrace a single principle: separation between communications services not subject to effective competition (*i.e.*, interexchange or exchange), and competitive offerings of any kind (*i.e.*, competitive communications services, communications equipment, electronics equipment, information services, and information software).

CCIA proposes that this principle be stated in a single section with appropriate modifications to, and cross references from, other affected sections.

The proposed language of the new section is as follows:

REQUIREMENTS FOR CARRIERS NOT SUBJECT TO EFFECTIVE COMPETITION

Sec. 2. (a) No carrier classified as a Category II carrier, and no carrier which provides an exchange telecommunications service for which such carrier is not subject to effective competition, shall sell, lease, or otherwise provide—

(1) Any telecommunications service for which such carrier is subject to effective competition,

(2) Telecommunications equipment,

(3) Electronics equipment,

(4) Information software, or

(5) Information service,

except through a fully separated entity.

CCIA proposed amendment 2

S. 611 proposes a "fully separated" relationship between certain Category II carriers or non-competitive exchange carriers on the one hand; and entities or carriers offering competitive services or products on the other. The definition of "fully separated entity" or "fully separated carrier" is presently set out at page 6, lines 1 through 9, as follows:

(11) 'Fully separated entity' or 'fully separated carrier' means an entity or carrier owned or controlled by or under common ownership or control with another entity or carrier which does not have common directors, officers, employees, or financial structure, or commonly owned facilities with such other entity or carrier, and which deals with such other entity or carrier in the same manner (according to the same arms-length arrangements) as it deals with any unaffiliated entity or carrier.

However, even if full separation precludes common directors, officers, employees, financial structure or commonly owned facilities, the fact remains that the Category II carrier or non-competitive exchange carrier *owns* the fully separated entity or carrier. As the shareholder in such fully separated entity or carrier, it elects and unseats directors, who in turn hire and fire officers, who in turn hire and fire other key employees. Inevitably, with the ownership relationship comes a very strong *control* relationship and, of course, a financial interest in the success of the fully separated entity or carrier over competitors.

In short, there is a strong financial incentive to subsidize or otherwise provide advantage to a fully separated entity or carrier where possible. This proposed CCIA change, therefore, deals with the primary areas where a Category II carrier or non-competitive exchange carrier could either financially subsidize a fully separated entity or carrier, or provide valuable non-financial subsidies, i.e., transfer valuable competitive advantages without commensurate compensation. (See Figure 1 for a diagram of the major subsidies involved.)

CCIA, in this Amendment "2," proposes that S. 611 address these crucial problems by adding a new section articulating the "arms-length" principle already embraced in the definition of "fully separated entity or carrier" (page 6, lines 1 through 9). The specific language of the proposed section is as follows:

DEALINGS BETWEEN FULLY SEPARATED ENTITIES OR CARRIERS

SEC. 2. (a)(1) Fully separated entities, and fully separated carriers, shall deal with any entity or carrier from which they are fully separated in the same manner (according to the same arms-length arrangements) as they deal with any unaffiliated entity or carrier.

(2) Any entity or carrier owning or controlling, in whole or in part, a fully separated entity or carrier shall deal with such fully separated entity or carrier in the same manner (according to the same arms-length arrangements) as they deal with any unaffiliated entity or carrier.

(b) No Category II carrier, and no exchange carrier not subject to effective competition shall:

(1) provide any communications service to a fully separated entity or carrier, for direct use or resale, unless such service is made available under tariff to both such fully separated entity or carrier, and unaffiliated entities or carriers, on the same terms and conditions,

(2) procure any telecommunications equipment, electronics equipment, telecommunications service, information service, or information software from a fully separated entity or carrier, unless it has first provided an equal opportunity for all interested entities or carriers to offer competitive bids based upon a published functional specification and has rejected all bids from unaffiliated entities or carriers solely on the relative merits of the product or service offered,

(3) own or control, alone or with any other corporation directly or indirectly related by ownership, more than 67% of any class of securities of a fully separated entity or carrier. For purposes of this subsection, "securities" shall be defined as they are under the Securities Act of 1933,

(4) market jointly with, or allow its identity to be used in the marketing of, any fully separated entity or carrier; nor provide direct customer billing for any equipment or service, other than interexchange public message telephone service, of any fully separated entity or carrier, or

(5) make available to any fully separated entity or carrier the results of any research or development which it has at least partially funded, directly or indirectly, unless it makes such results available to unaffiliated entities or carriers on the same terms and conditions.

Subsection "(a)(1)" states the general principle that fully separated entities or carriers shall deal with the Category II or non-competitive exchange carrier from which they are fully separated, on an arms-length basis. Conversely, and more important, Subsection "(a)(2)" requires that *Category II and non-competitive exchange carriers* deal with fully separated entities or carriers on the same basis that they deal with unaffiliated firms. While the latter principle is obviously intended in the definition of "fully separated entity or carrier" (page 6, lines 1 through 9), the language of the definition is not entirely clear.

Subsection "(b)" states specific restrictions intended to prohibit key transactions or arrangements which are not arms-length.

Subsection "(b)(1)" is intended to insure that both resale carriers and competitive data processing service firms have the same access to the facilities of Category II carriers and non-competitive exchange carriers as any fully separated, but affiliated, entity or carrier would have.

Subsection "(b)(2)" is intended to implement the general principle that no Category II carrier or non-competitive exchange carrier as a supplier of any telecommunications equipment, electronics equipment, telecommunications service, information service, or information software, over unaffiliated entities or carriers.

This should eliminate, for example, the preferred supplier arrangement between A.T. & T. and Western Electric, in which the latter has a very large captive customer in the Bell system. This problem has been recognized, and the anticompetitive results attacked, by the Justice Department in both its present and preceding antitrust suits against A.T. & T. The Subsection further recognizes, however, that the *same* anticompetitive problems can exist with respect to *new* A.T. & T. subsidiaries which might provide electronics equipment, competitive telecommunications services, information service, or information software.

Subsection "(b)(3)" is intended to insure that investment, either equity (stock) or debt, does not constitute and outright subsidy to a fully separated entity or carrier. For example, if a fully separated entity or carrier were participating in a competitive market and losing \$50 million per year, new investment in a similar amount by the parent each year would keep the losing operation in business and allow it to price predatorily with respect to competitors; i.e., such investment would constitute a direct financial subsidy.

In essence, subsection "(b)(3)" is intended to establish the principle that no Category II or non-competitive exchange carrier shall make either equity or debt investment in any fully separated entity or carrier on terms or conditions more advantageous than would generally be available from prudent unaffiliated investors.

The CCIA Proposal in Subsection "(b)(3)" recognizes, however, that it would be inherently difficult for the FCC to determine whether such investment were "on terms or conditions more advantageous than would generally be available from prudent unaffiliated investors."

Therefore, the CCIA Proposal contemplates first, that the securities and banking marketplace determine whether such equity or debt investment reflects generally prevailing investment conditions; and second, that the financial reports required to be filed by publicly held companies would substantially assist the FCC in determining whether investment were on an arms-length basis. It is fully intended that the minority public ownership requirement proposed by CCIA invoke Securities Exchange Commission (SEC) requirements for disclosure of transactions (e.g., indebtedness) between related companies.

Beyond the investment issue *per se*, however, this approach would substantially help to insure that the entire relationship between fully separated entities or carriers were on a true arms-length basis. For example, a subsidiary publicly held in this proportion would file corporate income tax returns with the IRS, as well as the full range of SEC reports required for publicly held companies; all of which would be available to the FCC to assist in monitoring the arms-length relationship.

The public investors would act as a further "check and balance" on the relationship between the fully separated entity or carrier in which they hold shares, and the related Category II or non-competitive exchange carrier (e.g., through annual shareholder meetings of the *subsidiary*, through the ability to elect at least some directors, and through shareholder suits). In addition, shareholders in a Category II or non-competitive exchange carrier would have a new interest in scrutinizing cross-subsidy to a fully separate affiliate which was *not* a wholly owned subsidiary (e.g., a subsidy to such a subsidiary would not entirely accrue to their benefit). In all cases shareholders, like the FCC, would have the benefit of the reports filed publicly held companies, in their efforts to scrutinize intercompany transactions which might adversely affect their interests.

A.T. & T. and other affected carriers would *retain control* of fully separated entities or carriers for all legitimate purposes, but would be subject to scrutiny with respect to any illegal or improper financial transactions.

There is statutory precedent for a public ownership requirement, in the Communications Satellite Act of 1962, at Section 304 relating the Communications Satellite Corporation.¹ Further, the FCC itself has set ownership restrictions with respect to competitive carriers such as Satellite Business Systems, wherein it restricted the ownership share of partners such as COMSAT General or IBM to 49 percent.²

Subsection "(b)(4)" precludes competitive affiliates of, for example, A.T. & T. from obtaining marketing "leverage" from the monopoly firm's virtually ubiquitous customer base. This section recognizes that, from a marketing perspective, it is much easier to "grow" an existing customer account than to establish a new one. Restrictions on the use of marketing identity and customer billing are intended to preclude, for example, either a Category II carrier or a non-competitive exchange carrier from providing both monopoly communications and other competitive offerings (communications or data processing) under a single identity, or to "bundle" competitive services with basic telephone service (i.e., implement a "tying arrangement). This restriction would put the competitive offerings of Category II or non-competitive exchange carriers on the *same* basis as those of unaffiliated competitors.

Subsection "(b)(5)" is intended to insure that monopoly-funded research and development at institutions such as Bell Laboratories does not unfairly advantage the competitive offerings of full separated A.T. & T. entities or carriers over those of unaffiliated competitors. Rather than precluding the transfer of monopoly-funded R&D to the fully separated entity or carrier, it makes such R&D results available to unaffiliated competitors on the same terms and conditions.

¹ See 47 U.S.C. 701-744; in the case of COMSAT, the public ownership requirement was set at 50 percent.

² 51 F.C.C. 2d at 38.

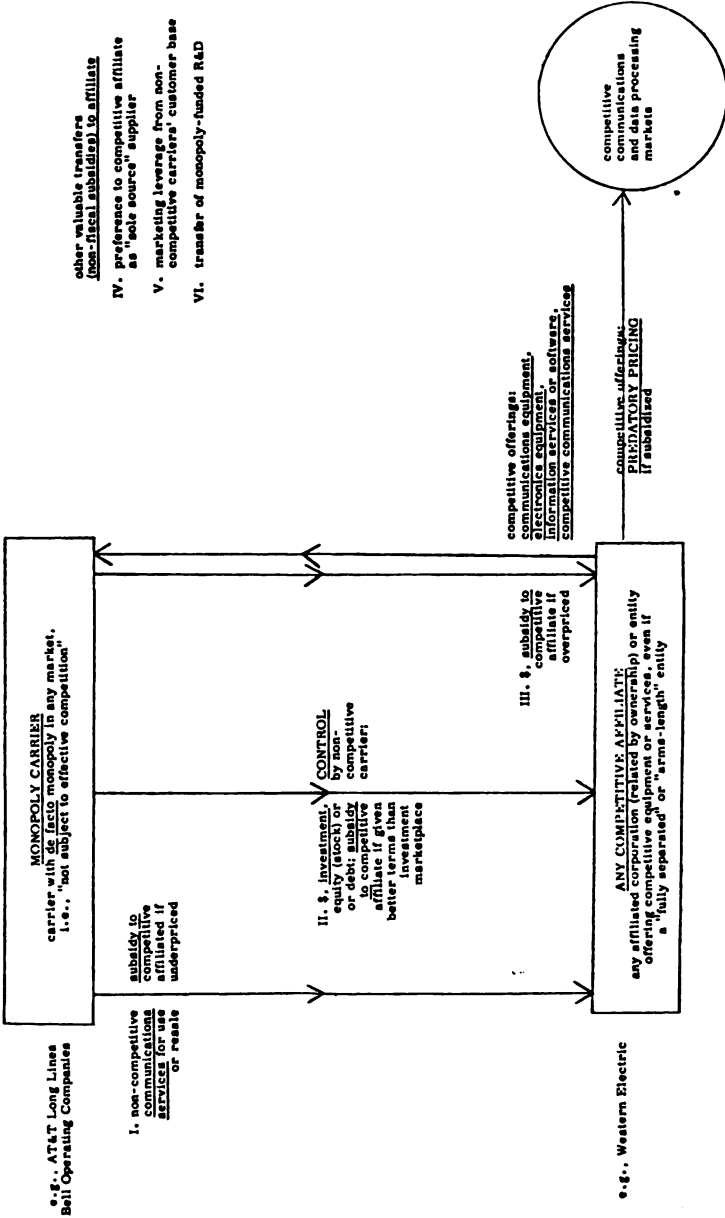


FIGURE 1
Dealings and Subsidies Between
"Fully Separated" or "Arms-Length" Entities

APPENDIX B

HISTORICAL ANALYSIS OF CROSS-SUBSIDIZATION AND DENIAL OF ACCESS

CCIA and its members are concerned that two fundamental anticompetitive results occur when dominant carriers (*i.e.*, those not subject to effective competition) are permitted to participate in competitive markets:

First, the dominant carrier can subsidize its competitive offerings with inflated monopoly revenues, thereby enabling it to engage in predatory pricing in competitive markets, and

Second, the dominant carrier can favor its competitive offerings by discriminating against competitors who require access to the dominant carrier's monopoly communications facilities.

The current draft legislation appears to recognize these problems, but does not effectively prevent such anticompetitive abuses from occurring.

The concerns of CCIA are not merely conjectural, but are founded upon the recorded experiences of the communications and data processing industries over the past 15 years.

This appendix documents this history in several key areas in which AT&T, as a dominant carrier, has faced competition. It is only illustrative, however, of the more pervasive manifestations of these problems. Specifically, similar cross-subsidies can be made with respect to *any* competitive offering of a dominant carrier, including communications equipment, data processing equipment, and data processing services. Further, denial of competitor access to monopoly communications facilities is as serious an anticompetitive problem with respect to providers of remote access data processing services as it is with respect to providers of competitive communications services.

It should be emphasized that the problems documented in this appendix are not merely historical. Two major FCC decisions within the last five months relating to AT&T's private line services and data services, respectively, indicate clearly that the problem of cross-subsidy is with us today, and will continue absent an *effective* means of preventing this anticompetitive behavior. Such abuses continue to harm not only AT&T's competitors, but ultimately, the public ratepayers as well.

CCIA submits that, to the extent that the pending legislation relies on accounting separation between monopoly and competitive offerings, regulatory history will forecast the future, and the anticompetitive dominant carrier practices that have been associated with competitive communications services will prejudice effective competition in communications equipment, computer equipment, and data processing services, as well. Effective enforcement of the stated intent of the Bill requires, if not divestiture, full corporate separation of dominant carrier communications services from all competitive offerings of such carriers.

I. CROSS-SUBSIDIZATION

A. *The private line cases*

In 1959 the Federal Communications Commission decided what has come to be known as the *Above 890* decision.¹ This case, which authorized point-to-point microwave communications by private entities and permitted the licensing of those systems, was the beginning of competition in the area of private line services. In 1961, in response to the new competition in private line services, AT&T filed a tariff for a service it called TELPAK. The TELPAK tariff offered substantial discounts to high volume business users of private line services. Shortly thereafter the Commission suspended, and ordered an investigation of, the TELPAK tariff in order to determine whether the tariff provisions were unjust or unreasonable.

The Commission found that the rates for two of the TELPAK services, TELPAK A and B, were non-compensatory and unlawful. After the United States Court of Appeals for the District of Columbia Circuit affirmed the Commission's decision, AT&T simply withdrew the TELPAK A and B offerings rather than file a compensatory tariff. With respect to the remaining TELPAK services, TELPAK C and D, the Commission found that despite its efforts to obtain sufficient economic data from AT&T, it was "unable to determine . . . that the rates for TELPAK C and D classifications are compensatory in relation to the costs of furnishing the services offered thereunder and, therefore, [was] unable to find that the other users of AT&T services will benefit and not be burdened by the application of such rates."² The

¹Allocation of Frequencies in the Bands Above 890 Mc., 27 F.C.C. 359 (1959), *reconsideration*, 29 F.C.C. 825 (1960).

²Tentative Decision in Docket 14251, ¶ 55, *quoted in* AT&T Tariff F.C.C. No. 1250, TELPAK Service, 37 F.C.C. 1111, 1118 (1964), *aff'd*, *American Trucking Ass'n, Inc. v. FCC*, 377 F.2d 121 (D.C. Cir. 1966), *cert. denied*, 396 U.S. 943 (1967).

Commission permitted the TELPAK C and D tariffs to become effective because of "competitive necessity," but decided to investigate further the question of whether the TELPAK C and D rates were compensatory.

Before the Commission concluded its further investigation into the TELPAK C and D rates, the Commission's initial concern about the possibility that AT&T was cross-subsidizing its competitive services was shown to have been well-founded. In September of 1965 AT&T completed a cost study of its various services. On the basis of AT&T provided data, this "Seven Way Cost Study" showed that AT&T's monopoly services were earning at a much higher rate of return than its competitive services. MTS, for example, was producing a rate of return of approximately 10 percent while the rate of return for TELPAK was only about 0.3 percent.³

In 1968, AT&T filed a revised TELPAK tariff. Again, the Commission found it necessary to suspend the tariff and institute an investigation to determine the lawfulness of the revised tariff. The investigation, Docket No. 18128, developed into a major investigation of the rate levels and ratemaking principles of AT&T's interstate services. Before its decision in Docket No. 18128, the Commission found, in a separate proceeding, that the TELPAK tariff was unlawfully discriminatory in violation of section 202(a) of the Communications Act of 1934.⁴ When in 1976, the Commission issued its decision in Docket No. 18128,⁵ it again found the TELPAK tariff to be unlawful and ordered AT&T to refile its TELPAK offering. Thus after 15 years of TELPAK service, the Commission still had not seen a lawful TELPAK tariff. The service was being offered to the public, but the Commission was unable to control the rates. And, after the decision in Docket No. 18128 was issued, AT&T decided to drop the service altogether.

During this period, AT&T filed several other tariffs for private line services. Each time the Commission has suspended the tariffs, in large part because of cross-subsidization problems. In 1973, AT&T filed a revised tariff for its series 2000/3000 (Hi-Lo) voice grade private line services. The Hi-Lo tariff was held unlawful in January of 1976 because AT&T has failed adequately to support its costing data or to show that the rates were compensatory.⁶ And, in 1978, the Commission rejected AT&T's revised tariff for its series 7000 private line service.⁷ The Commission specifically based its rejection on the fact that AT&T has submitted no costing information sufficient to assure the Commission "that AT&T's other Services categories including basic interstate telephone Service (MTS) are not bearing costs properly allocable to series 7000."⁸

Most recently, in March of 1979, the initial decision of Administrative Law Judge Walter C. Miller in a case involving the legality of series 2000/3000 and 5000 of Private Line Services (MPL tariff) was announced. Judge Miller found that AT&T failed to demonstrate that the tariff did not constitute unjust or unreasonable discrimination in violation of 47 U.S.C. § 202(a), and that AT&T had "not met or even attempted to meet the Commission's cost allocation guidelines set out in Docket No. 18128."⁹

B. Data digital service—DDS

Another example of the inability of the FCC to control cross subsidization of competitive services with revenues from monopoly services solely through accounting separation can be found in the DDS decisions. DDS is a private line service offering of interstate digital data communications that utilizes a technique called data under voice (DUV). Shortly after AT&T filed its initial tariff for DDS in 1964, the Commission began an investigation into whether the tariff was lawful. In its first decision in Docket No. 20288, the Commission found the rates to be unjust, unreasonable, unlawful and non-compensatory because AT&T had considerably un-

³ The Commission's inability to obtain adequate costing data was expressed in Commissioner Kenneth A. Cox's separate statement in which he stated:

"I discern a very disturbing pattern in connection with all the bulk rate tariffs which have been filed in recent years. AT&T offers new services which are very attractive to large users of communications. Protests are filed by competitors who claim that the tariffs are discriminatory and will result in damage to their business. The Commission suspends the tariffs, but they go into effect at the end of the statutory 90-day period. Customers are attracted and come to rely on these services. If and when, months later, we find the tariffs to be unlawful, we are besieged by users complaining that it would be unfair to withdraw the benefits they have come to value. . . ."

⁴ TELPAK Tariff Sharing Provisions of AT&T and Western Union Tel. Co., 23 F.C.C. 2d 606, reconsideration, 26 F.C.C. 2d 862 (1970), *aff'd in part and rev'd in part*, AT&T v. FCC, 449 F. 2d 439 (2d Cir. 1971).

⁵ AT&T, 61 F.C.C. 2d 587 (1976).

⁶ AT&T, 58 F.C.C. 2d 362 (1976).

⁷ AT&T, 67 F.C.C. 2d 1134 (1978).

⁸ *Id.* at 1135.

⁹ Preliminary conclusion No. 2, at p. 68 (emphasis added).

derstated DDS investment and expenses and had over-stated revenues by 510 percent.¹⁰ In addition, the Commission found that AT&T's noncompensatory pricing had an anticompetitive effect on the market. The Commission stated:

"We have found, both in the *Specialized Common Carrier* decision, *supra*, and as a result of our economic analysis in our First Report in Docket No. 20003, FCC 76-879 (released September 27, 1976), that significant public benefits result from competition in the provision of private line services. * * * Where the rates of one carrier for a service are so low as to constitute an anticompetitive practice, however, customers of that service may temporarily benefit from lower rates. This, however, is an immediate burden on ratepayers of other services, whose rates must subsidize the anticompetitive rates, and an ultimate detriment to the subsidized service's customers, who will be deprived of the benefits of competition. *We find, according to the facts delineated herein, that the unreasonably low price of the DDS service and the methods used in setting that price, could deprive the public of the benefits of competition and are contrary to the public interest.*"

"* * * [w]e agree with the Trial Staff that even if "[w]e cannot find the market simulations were deliberately deceptive" (ID, para. 116), *there is sufficient evidence in other internal AT&T documents, which explicitly indicates that AT&T was aware of the fact that DDS, at least initially, would not meet the overall rate of return requirement and moreover would require a subsidy from monopoly services.*"¹¹

Following instructions from the Commission, AT&T filed a revised DDS tariff. In 1978 the Commission found that the revised tariff failed to provide meaningful cost, market and expense data.¹² In affirming the 1978 decision in a January 5, 1979 decision the Commission demonstrated its frustration at not being able to obtain sufficient costing data from AT&T by stating that "throughout the lifetime of this service AT&T has failed to justify the lawfulness of the rates which it has filed." In response to AT&T's assertion that it has used its best efforts to supply the Commission with the necessary economic data, the Commission stated:

"We strongly disagree with AT&T's depiction of itself as a beleaguered regulatee, frustrated in its good faith attempt to comply with shifting Commission criteria. AT&T is not a recent entrant into the common carrier field for whom the task of justifying rate discriminations in the provision of like communication service is one of first impression. We think AT&T's current protests bespeak its intransigence rather than a misunderstanding of our tariff support requirements. Had AT&T sought to fully comply with the DDS Decision, it could easily have drawn upon its vast experience in proceedings before this Commission or, for that matter, employed ordinary common sense in interpreting the term "fully justify" to mean that it must show how specific cost differences result in specific rate differences. *AT&T's failure to do so is particularly inexcusable in view of its past similar behavior with respect to DDS and other services.* That our cost justification requirements extend beyond the superficial and the general is evident from our refusal to accept equally incomplete support materials in other proceedings."

C. Wide area telecommunications service—WATS

It is worth noting that the Commission has had similar problems in obtaining cost justification of AT&T tariffs for services that have traditionally been considered noncompetitive services. During the period 1974-1976, AT&T filed several revisions to its WATS tariff. In 1976 the Commission found all of these tariffs to be unjust, unreasonable and unlawful.¹³ In a concurring statement, Commissioner Abbott Washburn decried the fact that—

"After the public has been paying these rates for * * * years we have no way of assuring that the new tariffs will be any better or worse than the present unlawful tariffs which they will replace. The result is a series of Bell tariffs, all of which the Commission finds unlawful but which customers must pay. Refunds cannot be made despite the accounting order, because we have no legal tariff with which to compare and compute any overcharges. *The Commission, therefore, has essentially lost control over the rates Bell charges customers.*"¹⁴

¹⁰ AT&T, 62 F.C.C. 2d 774, 801 (1977), *reconsideration denied*, 64 F.C.C. 2d 994 (1977).

¹¹ *Id.* at 799-801 (emphasis added).

¹² AT&T, 67 F.C.C. 2d 1195 (1978).

¹³ AT&T, 59 F.C.C. 2d 671 (1976).

¹⁴ *Id.* at 715 (Washburns, Comm'r., concurring). It is interesting to note that in March of this year Administrative Law Judge Miller had the following to say about Commissioner Washburn's statement:

"In the WATS decision, Commissioner Washburn . . . concluded that the Commission has lost control over the rates Bell charges its customers. Actually he was understanding the problem. You cannot lose what you never had. A careful reading of the historical background shows that the Commission has never had any control over Bell's rates."

When AT&T filed a revised tariff in 1977, the Commission again found the tariff to be unlawful because of insufficient costing data received, and used the extraordinary remedy of rejecting the tariff.

Despite the fact that DDS tariffs have been before the Commission for more than six years, AT&T has yet to present to the Commission sufficient data to support a lawful tariff and has been offering DDS at an unlawful and noncompensatory rate for the entire period.

In sum, the history of the Commission's attempts to control anticompetitive abuses through accounting principles has proved an abysmal failure. The most that can be said is that the Commission has been aware of the problems. The long history of the lack of legal tariffs in such major competitive services as private line services and DDS demonstrates that simple recognition of the problem does not solve the problem. The problem remains and the Commission has been unsuccessful in its attempts to effectively deal with it.

II. DENIAL OF ACCESS

Section 202 of the Communications Act of 1934 provides that carriers may not unreasonably discriminate in charges or practices or give unreasonable preference to any class of persons. Section 201 of the Act provides that carriers must establish physical connections with other carriers whenever the Commission finds it "necessary or desirable in the public interest to do so." The history of the interconnection policies of AT&T, however, indicate that this statutory mandate has not always been met with compliance.

It is crucial that Congress make the principle of interconnection enforceable. In order to do this, Congress must ensure that "corporate separation" is required and that fully separated entities thereby access a dominant carrier's facilities on the same terms and conditions as competitors, i.e., under tariff.

In 1971 in its *Specialized Common Carrier* decision, the Commission clearly indicated that it expected common carriers to permit interconnection upon reasonable request, and it expected no discrimination in a carrier's dealings with affiliated carriers. The Commission stated:

"We reaffirm the view that established carriers with exchange facilities should, upon request, permit interconnection of leased channel arrangements on reasonable terms and conditions to be negotiated with the new carriers, and also afford their customers the option of obtaining local distribution service under reasonable terms set forth in the tariff schedules of the local carrier. Moreover * * * where a carrier has monopoly control over essential facilities we will not condone any policy or practice whereby such carrier would discriminate in favor of an affiliated carrier or show favoritism among competitors."¹⁵

Despite the Commission's admonition, however, A.T. & T. has proved reluctant to interconnect with other carriers. Despite the *Special Common Carrier* decision A.T. & T. refused to provide interconnection necessary for MCI to furnish private line services. MCI sought and obtained from the Commission an order that A.T. & T. must provide essential connections to the services that the specialized carriers were authorized to offer.¹⁶ Then, when MCI offered, and the United States Court of Appeals for the District of Columbia Circuit held that MCI had the right to offer, its Execunet service, A.T. & T. again refused to provide interconnection facilities for that service. MCI was forced to go to the Commission and then the United States Court of Appeals for the D.C. Circuit to compel A.T. & T. to provide such facilities. In its decision, the court had some scathing words for A.T. & T.'s behavior:

"MCI has met with almost continuous resistance from A.T. & T. in its efforts to provide communications services. We had thought that this process finally culminated in our *Execunet* decision upholding MCI's authority to offer Execunet pending further rulemaking by the Commission. Now, however, we are faced with a new

¹⁵ *Specialized Common Carrier Services*, 29 F.C.C. 2d 870, 940 (1971).

¹⁶ *Bell System Tariff Offerings*, 46 F.C.C. 2d 413 (1974), *aff'd sub. nom. Bell Telephone Co. v. FCC*, 503 F.2d 1250 (3d Cir. 1974), cert. denied, 422 U.S. 1026 (1975).

effort by A.T. & T., with the approval of the Commission, to arrest the development of Execunet service * * *.

"Having successfully litigated the question of its right to provide Execunet service, MCI certainly has good cause to feel that this subsequent turn of events engineered by the Commission and A.T. & T. is strikingly unfair * * *.

"Our Execunet decision did clearly contemplate—by virtue of A.T. & T.'s representations and actions—that A.T. & T. was required to provide interconnections for Execunet service * * *."

Finally, four pending antitrust suits allege that A.T. & T. consistently has withheld interconnection facilities from competing carriers.¹⁴ That three major competitors of A.T. & T., as well as the U.S. Justice Department, have filed independent law suits over A.T. & T.'s interconnection policies should indicate that the problem of discrimination does exist. As presently written, S. 611 will not remove the incentive for A.T. & T. to discriminate against competitors. Therefore, it must provide for effective enforcement of equitable access to dominant carrier facilities; that is, it should require competitive offerings of a dominant carrier to be made through a fully separated entity which accesses the dominant carrier's facilities under tariff.

III. CONCLUSION

This brief summary of the Commission's futile attempts to control and prevent anticompetitive abuses in the tariff rates for A.T. & T.'s competitive services amply illustrates that the history of accounting separation is a history of "a series of unauditable, inaccurate and unreliable cost studies."¹⁵ As recently as January 1979, the Commission's decision on DDS reaffirmed its finding that the DDS rates are noncompensatory and again in March of this year, Administrative Law Judge Miller's MPL decision reflects his, and the Commission's, frustration over their inability to obtain appropriate costing and pricing data from A.T. & T.

A.T. & T.'s anticompetitive underpricing of competitive services has existed as long as A.T. & T. has been involved in competitive services. Clearly the experience of fifteen years of attempted accounting separation points to the conclusion that it simply is unworkable,¹⁶ and cannot provide the basis of an effective statutory framework for a competitive industry structure.

APPENDIX C

ECONOMIC ANALYSIS OF CROSS-SUBSIDIZATION

The current legislation attempts to deal with the potential for cross-subsidy between the monopoly and the competitive services of communications common carriers in general and the Bell System in particular. This appendix examines the economic incentives, the capability, and the nature of this cross-subsidization. It then considers several alternative methods of controlling cross-subsidy, specifically regulation through accounting procedures, creation of fully owned corporate subsidiaries, creation of partially owned corporate subsidiaries, and full divestiture. Most of the discussion relates to AT&T and the Bell System, although it will be relevant in varying degrees to other telephone common carriers as well.

Incentive to cross-subsidize

The American Telephone and Telegraph Company is a corporation devoted to profit maximization. Its management serves at the pleasure of its directors, who in turn are representatives of its shareholders. Within the corporate structure, AT&T's management has no other loyalty. It will always act in the interest of the company's

¹⁴ *MCI Telecommunications Corp. v. FCC*, 580 F.2d 590 (D.C. Cir. 1978).

¹⁵ There are suits by now bankrupt Datron, MCI, and Southern Pacific Communications, and the U.S. Justice Department.

¹⁶ Initial Decision in Docket 20814, March 1979 at ¶ —.

¹⁷ Walter Hinchman, former Chief of the Common Carrier Bureau, recently had the following to say about the Commission's attempts to control A.T. & T. abuses through accounting and allocation examinations:

"The system is largely beyond the effective reach of both Federal and State regulation and may, therefore, be impervious to most attempts at competition as well. * * * How much of our concerns about proper cost accounting and allocation, anti-competitive pricing and many other matters would either be alleviated or disappear were it not for the pervasiveness of the Bell System."

Remarks by Walter R. Hinchman before the International Communications Ass'n, May 15, 1978.

shareholders, notwithstanding the fact that the Bell System which it operates furnishes over 90 percent of the nation's telephone common carrier service. When either public interest or competitive freedom conflict with AT&T's profit maximization, the Company's managers can be expected to act in accordance with the latter.

This observation is not a moral judgment. The motivation of AT&T's management reflects the same system of incentives which operates on all corporate managements in the American free enterprise system. It is how the system works, and the results attest to its success. The composite effect of thousands of individual and corporate managers acting in their own self-interest has given this nation the strongest, wealthiest, and most productive economy in the world.

While AT&T's management is like that of any other corporation with respect to incentives, it is quite dissimilar in two other important respects. First, AT&T (and the Bell System, which it operates) sells its products and services in an extraordinary mix of market conditions which range from full monopoly to a high degree of competition. Second, AT&T's management commands immense financial and market power, beyond that of possibly any other corporation in the nation.

The mix of market conditions leads to a mix of pricing incentives. In its monopoly markets, AT&T's incentive is to maximize profit by setting prices as high as the market will bear within the limits imposed by regulation. Because the Bell System's monopoly services are particularly important to consumers, AT&T has the potential ability to set prices substantially above the cost of production, including the minimum return on investment needed to attract capital.

In its competitive markets, the Bell System's prices are limited by the prices offered by competing enterprises. If AT&T operated only in these competitive markets, its profit maximization would take the form of cost reductions, technological innovations, or the introduction of specialized offerings which permit customers to assign greater value to Bell System products or services than to the products or services of competitors.

The Bell System merges these two market conditions, and this merger seriously distorts the system of pricing incentives under which Bell's management operates. AT&T's incentive is to cover the cost of its competitive services from the profits derived from monopoly services. In this manner, AT&T is able, over time, to convert competitive markets into monopolies by driving competitors from the field. Later, when competition has been extinguished, the previously competitive services can be priced as monopolies. Potential competitors will be discouraged from challenging these monopoly prices because they know that AT&T can and will respond to any threat of price undercutting.

The best opportunities for expanding the Bell System's sphere of monopoly are in products and services which are peripherally related to the System's existing monopoly over switched communications. One of the obvious targets is data processing. Data transmission, over which Bell already has a quasi-monopoly, is merely the flow into and out of data processors. Those data processors, their software, hardware, and design services, represent one of the principal competitive markets which Bell can be expected to attempt to draw into its monopoly orbit.

The foregoing describes the incentives which operate on AT&T in the absence of some form of institutional restraint. The more capable AT&T's management, the more aggressively it will pursue these incentives. This is because these incentives are altogether consistent with management's obligation to maximize the return to the Company's stockholders.

The ability to cross-subsidize

Obviously, the incentive to cross-subsidize competitive services with monopoly profits translates into actual cross-subsidy only if the corporation has the financial power to do so. This power must be sufficient both relatively and absolutely. Relatively, the base monopoly products or services must represent a sufficiently large proportion of the firm's total business to permit the diversion of profits to support the less profitable competitive services without undermining the financial integrity of the company. On an absolute basis, the Company must have sufficient resources to develop new markets or invade existing markets in the face of potential competitors, some of whom may be substantial organizations themselves. It must be able to develop or procure the technology, master the operations and techniques of production, build an operating organization, and field a marketing effort in a line of business which is considerably more risky than that in which it is already engaged.

On both bases, relatively and absolutely, AT&T and the Bell System are equipped as no other private enterprise in the nation to engage in competitive cross-subsidization.

First, from the relative standpoint, it is generally conceded that public local switched telephone service, exclusive of terminal apparatus, is a full monopoly within each telephone company's service area. Local service revenues of the Bell

System are just under half its total revenues. Intercity toll service is nominally subject to competition, but the exchange connections continue to be a Bell monopoly. Furthermore, the extent of the competitive invasion of this market is so small as to fail the test of "effective competition" under virtually any standard. Toll Service, including WATS, accounts for another 43 percent of the Bell system total revenue.

Bell faces some competition for intercity private line service, but only on certain routes between major cities. Intercity private line service generates only about 5 percent of the System's entire revenue, and the truly competitive market is some fraction of that amount. The other area where Bell faces competition is in terminal equipment. While the terminal equipment accounts combined represent about 20 percent of Bell's total investment, the actual competitive market is a relatively small portion of the total, principally PBX equipment, business key sets, and decorator home handsets. Thus, at most, only about 10 percent of the Bell System's total business is subject to competition. This means that 90 percent of the Bell System's business can be martialed to subsidize the remaining 10 percent which faces competition.

If anything, these ratios are even more exaggerated for the independent telephone companies, most of which do not offer extensive intercity private line service. Thus, the relative ability to cross-subsidize is an industry-wide characteristic.

But it is with respect to *absolute* financial resources that AT&T differs altogether from any other telephone company or, for that matter, any other company whatever in the nation. Its assets, now approaching \$100 billion, are greater than the wealth of all but a relative handful of nations in the world. Its \$41 billion annual gross revenues in 1978 came to 2 percent of the nation's Gross National Product. Its financial resources overwhelm those of any present or potential competitor. The largest potential competitor is IBM, but even its revenues are only 45 percent those of AT&T, its assets proportionately smaller, and the portion of business potentially competitive with AT&T smaller yet. Much the same is true of the second strongest potential competitor, ITT. Its gross revenues are 12 percent those of AT&T, but only a tiny fraction are derived from the lines of business which are threatened by AT&T's competition. As for other competitors, their *combined* revenues come to only about a quarter of AT&T's gross revenue. As a consequence, AT&T need divert only a small proportion of its monopoly revenues to match the total revenues of any of its carrier or data processing competitors.

Methods of cross-subsidy

The problem of cross-subsidy has been recognized by the Federal Communications Commission for two decades, but it remains unresolved today. This lack of resolution persists even though (1) the FCC and the state regulatory commissions limit the overall earnings of the Bell System companies, (2) the FCC and state commissions have full control over both the monopoly and competitive service prices of the Bell System companies, and (3) the FCC and numerous state commissions have made repeated attempts to have A.T. & T. and the Bell System companies calculate the specific costs of both monopoly and competitive services.

The following discussion explores the means by which A.T. & T. could engage in cross-subsidy in this regulatory environment. Cross-subsidy, as used herein, means the diversion of resources from the monopoly services to the competitive services without full compensation being made by the latter. The techniques of cross-subsidy fall into five general categories: (1) Assignment of Plant; (2) Vertical Integration; (3) Financing; (4) Marketing; and (5) Research and Development.

1. Assignment of plant

To date, all efforts to calculate the cost of the monopoly and the competitive services offered by the Bell System have been impeded by three characteristics of the System's plant.

First, is the existence of large amounts of *common plant*. This plant includes towers, poles, antennas, buildings, frames, switching machines—all of which serve the combined requirements of all services which use them. An example of common plant is the electronic message switching computer. These computers are capable of many functions aside from switching telephone messages. They can be employed to store, retrieve, edit, calculate, manipulate, and transfer data which is fed in over the telephone lines which access it. Since most of the facilities which feed the computer as well as significant components of the computer itself are used in common by both communications and data processing functions, it becomes virtually impossible to segregate the costs between these two activities on any objective basis. Lacking an objective basis, A.T. & T. can adopt an arbitrary one, possibly treating the data processing function, which is competitive, as "incremental," or additive to the basic monopoly communications function. Under this procedure, the monopoly services bear the cost of all base facilities, while the competitive service is

assigned only the supplemental costs needed to extend the computer's capabilities to data processing.

The second characteristic of Bell System plant which impedes the accurate assignment of costs is *fungibility*. Fungibility relates to the interchangeable nature of most telecommunications plant, that is, the ability of different facilities to perform identical functions, and conversely, of identical facilities to perform different functions. Transmission systems offer a good example. They can transmit signal grade, voice grade, or wide-band signals; voice, data, telephoto, or video-type messages; yet they are not themselves uniform. They may take the form of radio facilities, coaxial cables, copper wire cables, or prospectively, optical fibers—any of which can transmit in the digital or the analogue mode. As a consequence of fungibility, any given service can be handled on a wide variety of transmission facilities having vastly different costs. Conversely, any given transmission facility can be assigned to a variety of different services. This characteristic permits A.T. & T. to assign plant, either for costing purposes or for purposes of physical routing, according to a predetermined cost result. For example, it can assign low cost, high density state-of-the-art facilities to its competitive services, and allow the monopoly services to absorb the cost of the expensive, low density, and technologically obsolescent facilities.

The final characteristic of telecommunications plant which has impeded cost ascertainment is the problem of *capacity utilization*. At no time is the entire telecommunications network fully utilized. The efficiency of high density transmission has required A.T. & T. to construct facilities with capabilities far beyond immediate demand in the anticipation that future growth in communications requirements will, over time, absorb the unused capacity. The allocation of the present cost of this unused capacity is largely, if not entirely, a judgmental function. The FCC has attempted to assign this reserve capacity on the basis of projections of future growth, but such projections inevitably reflect the judgment of the carrier. The carrier need only understate the prospective growth of competitive services and overstate the growth of monopoly services to effect a cross-subsidy which, by its nature, is undetectable by regulators at the time it is made.

These three characteristics, common plant, fungibility, and the problem of capacity utilization, have been largely responsible for the FCC's rejection of the cost studies supporting virtually every competitive service filing made by A.T. & T. in the last decade.

2. Vertical integration

The Western Electric Company either manufactures or purchases as an agent virtually all types of facilities and equipment used by the Bell System companies. Most of the equipment requirements of the Bell System are met from this one source, with only lip service paid to competitive procurement for some items. Equipment furnished by Western Electric is used to provide both monopoly and competitive services. The transactions between Western Electric and the operating companies are not monitored or regulated other than indirectly through the regulation of the Bell System's communications services.

This relationship, which can be characterized as a bilateral monopoly, (a single supplier selling to a single purchaser, itself a monopoly) offers a tempting opportunity for abuse of Bell's monopoly position. The Bell System is in a position to pass through the profits on its monopoly services in the form of excessive prices paid to Western Electric for facilities and equipment used by monopoly services, and then to reduce prices of equipment used by competitive services, thereby subsidizing the latter.

Hitherto, both monopoly and competitive services have used largely the same equipment, so that cross-subsidy has been to some extent circumscribed. As long as the price for a given item does not vary depending upon its end use service, and as long as most communications equipment is fungible, that is, usable for either monopoly or competitive services, there is a practical limit on the ability of the Bell System to engage in this sort of cross-subsidy.

But if the Bell System were to invade non-communications markets, such as data processing, this practical limitation would be removed. Its data processing equipment would be used primarily in competitive markets, while its communications equipment would be used primarily for monopoly services. Thus, although the Bell System's vertical integration may have been tolerable in the past, its penetration into competitive non-communications markets will open new opportunities for cross-subsidy through vertical integration.

3. Financing

The Bell System's competitive services derive their capital from the same sources as its monopoly services. Those sources are debt capital, usually issued in the name

of the operating company, and equity capital, which flows from the parent organization. This capital is fungible in application to the entire range of Bell's services and products, competitive and noncompetitive. For this reason, Bell System competitive services, standing alone, need not be profitable. AT&T's investment decisions are based on the *combined* effect of competitive and monopoly services, as described in the foregoing discussion of incentives. Thus, AT&T can invest in a "loss leader" competitive service if, in the long run, that investment contributes to the extension of the Bell System's monopoly orbit.

In this respect, AT&T is aided by the FCC's regulation of overall earnings from the aggregate of interstate services. If these earnings fall, AT&T has a right by law and by regulatory precedent to request rate increases sufficient to permit the Company to attract capital, maintain credit, and earn a return on investment comparable to that of enterprises of corresponding risk. Since the vast majority of the Bell System revenues are derived from monopoly services, this upward rate adjustment will generate revenue primarily from monopoly services, even if the earnings shortfall is due primarily to the underpricing of competitive services.

4. Marketing

A little recognized advantage which AT&T's competitive services enjoy is the integrated Bell System marketing organization in which a single staff and a coordinated advertising program promote both monopoly and competitive services. The Bell companies present their services to the customer as a "total system" in which the monopoly and the competitive services are so intertwined that the customer perceives them as a unified service incapable of segmentation. In this manner, competitors find it difficult to persuade customers that a service which Bell offers can be furnished by another supplier at equal or lower cost and with greater efficiency. The concept of the "total system" extends to all facets of Bell's business, planning and procurement, maintenance services, and payment procedures.

In addition to the marketing advantage of an integrated promotional program, there is a costing advantage resulting from the fact that sales, advertising, and customer service expenses are classic examples of common costs. The cost of Bell's marketing program is virtually incapable of any kind of objective and refined allocation based on causality. The general practice is to treat marketing cost as an "overhead item" on base costs, a procedure which invariably understates in marketing cost associated with competitive services or products. Obviously, the competitive services or products require a disproportionate effort by the marketing staff relative to monopoly offerings which the customer must procure from the Bell System in any case. This is particularly true of Western Electric equipment where the Bell System furnishes an enormous captive sales base capable of supporting a marketing program which can overwhelm any competitor.

Thus, marketing furnishes a double subsidy of competitive services. The first is furnished by integrating the promotion of competitive with monopoly services. The second is generated by allocating the marketing costs disproportionately to monopoly relative to competitive services.

5. Research and development

The research and development for the Bell System is handled through the Bell Laboratories, Inc., one of the world's most extensive private research and development operations. The Bell Labs are supported by a "license contract," which is an assessment on each Bell System operating company equal to a percentage of its total investment and expenses. As noted above, about 75 percent of the Bell System's business relates to monopoly services, so that these services overwhelmingly support the Bell Laboratories. Yet Bell Laboratories develops facilities, equipment, and computer software which are used in both monopoly and competitive services. Indeed, to the extent that competitive services are at the forefront of technological development, the Bell Laboratories may spend a disproportionately higher percentage of its resources on developments relating to present or potential competitive markets.

There is no mechanism for tracing the benefits of the Bell Labs research and development through to the services which are the ultimate beneficiaries. In fact, Bell Labs normally conducts its research and development with little or no specific orientation to the end-use service. The Bell Labs "License Contract" is treated as an "overhead" on the costs assigned to each service. If those costs are overstated, the contribution to Bell Labs is similarly overstated. Conversely, if they are understated, the Bell Lab's contribution is correspondingly understated. Thus, the "license contract" has two effects. First, it furnishes research and development to competitive services which is supported by monopoly services. Second, it exaggerates whatever overstatement of monopoly service costs and understatement of competitive

service costs may exist as a result of other cross-subsidizing cost assignments or allocations.

Control of cross-subsidy

As demonstrated by the present legislative proposals, there is a general recognition that cross-subsidy requires some institutional control mechanism. There appears to be some consensus that the best method of control is to separate monopoly from competitive offerings to regulate the former, and to permit the latter to operate freely in the marketplace—or at least with a degree of regulation substantially less than that now applied to monopoly services. There is a range of separation mechanisms which can be categorized as follows: accounting separation; integrated corporate subsidiaries (similar in relationship to the present Bell System operating companies); full corporate separation in which any competitive subsidiary must maintain separate directors, management, marketing staffs, and facilities; full corporate separation with minority public ownership; and full divestiture.

The efforts of the FCC to isolate the costs of Bell's competitive services from those of its monopoly services during the last two decades have demonstrated the bankruptcy of the first alternative, accounting separation. While the view has been expressed that a new accounting system might resolve the problems of cost allocation that have troubled the FCC for 15 years, this view fails to recognize the intrinsic characteristics of communications plant described above, common plant, fungible plant, and reserve plant. These characteristics will not be changed by any revision in the accounting system. An accounting system can classify plant only on the basis of stable characteristics, its physical properties, its locations, or its assignment if that assignment remains stable for any period of time. But the assignment of telecommunications plant among services is inherently unstable. Plant is shared among services, its assignment is subject to continuous change, and its use by an individual service is largely unrelated to its technology. Even if an accounting system could follow accurately and reliably the assignment of plant to services and vice versa, it would still reflect the plant assignment policies of the carrier which, as discussed above, can be adjusted to yield a predetermined costing result.

The remaining mechanisms for controlling cross-subsidy involve the creation of separate corporate subsidiaries to perform competitive services. A corporate subsidiary is a viable method of eliminating the cross-subsidies resulting from plant assignment only if competitors have identical access as the subsidiary to lease or purchase facilities or services from the parent monopoly enterprise. Absent this access, there is essentially no improvement in accountability over cross-subsidy relative to the condition which exists under so-called "accounting separation." AT&T can underallocate common costs, assign low cost fungible plant, and understate the reserve capacity requirement of its competitive subsidiary in similar fashion as it can treat its competitive services. Only if the results of these cost distortions are made available to outside competition will AT&T be discouraged from making them.

In similar fashion, separate corporate subsidiaries will control the cross-subsidy potential of vertically integrated suppliers and research and development operations only if these resources are made available to outside competitors on the same basis as to the subsidiary corporations. Western Electric and Bell Laboratories will continue to furnish monopoly supported advantages to Bell System competitors as long as those two organizations can limit their dealings to members of the Bell corporate family. Thus, control of this source of cross-subsidy is contingent upon comparable access by all competitors to Bell's manufacturing operations and to its research and development activities.

The type of parent-subsidiary relationship which now exists among the Bell System companies would still perpetuate one of the most potent forms of cross-subsidy, that relating to marketing. Under present conditions, Bell operating companies promote their own service, the service of AT&T Long Lines (and vice versa), and the products of Western Electric. As long as this relationship continues, any Bell System competitor will have a powerful, monopoly supported advantage over outside competitors. The subsidiary will have access to the contacts and the detailed customer information furnished by the marketing department of the monopoly parent. Marketing will continue to reflect the "total system" concept in which competitive and monopoly enterprises are presented to the customer as a single package largely incapable of dismemberment into discrete sub-services.

The only effective means of eliminating this form of cross-subsidy is a requirement for totally separated managements, including independent procurement, marketing, advertising, billing, and customer service functions. Only when the Bell subsidiary is presented to the public as another independent competitor will its position in the market be freed of the support of Bell's monopoly power.

Even with fully separated management, operations, and facilities, a competitive Bell System subsidiary can still receive subsidies in the form of low-cost financial

support. AT&T would have the opportunity to make available capital to its competitive subsidiary with no requirement for a commensurate return. It can distort its subsidiary's capital structure by relieving it of any debt obligation, thus permitting it to operate at little or no net revenue margin in the face of its competition. This abuse can be resolved by a requirement that the subsidiary maintain substantial minority ownership by the public, which opens to public scrutiny any intercorporate practice which undermines the competitive enterprise's services to the ultimate benefit of the monopoly parent. The minority shareholders would require that the competitive enterprise earn a compensatory rate of return. Similarly, the parent's stockholders might object to excessive subsidies flowing to the subsidiary, the owners of which are not the same as the parent. Any expansion in the capitalization of the subsidiary involves a public stock offering, which in turn would require a record of earnings performance comparable of that of other enterprises engaged in the same line of business.

The proportion of minority ownership should be large enough to require an independent federal income tax return. Not only would a separate tax return produce a public accounting of the subsidiary's capital structure. An all equity capitalization, for example, would generate such an excessive income tax bill that the minority shareholders would have a legitimate claim that their interest had been sacrificed to the broader corporate objectives of the parent.

Full corporate separation with a substantial minority interest by public shareholders would inhibit most of the potential abuses of AT&T monopoly power, that is, its power as a single seller of equipment and services, yet it still would not effectively control the abuses of Bell's monopsony power—as a single buyer of equipment and services. If Bell chooses to buy from a single supplier, and that supplier happens to be a Bell System subsidiary, the best that can be done is to require competitive purchasing, a requirement which is extremely difficult to enforce. The only truly satisfactory method of eliminating this kind of parent-subsidiary support is full divestiture. Not until all suppliers are totally independent of the Bell System can AT&T's purchasing decisions be expected to be fully objective.

CONCLUSION

Congress has before it several proposals to lift the previous limitations on AT&T's entry into non-regulated, competitive markets. These proposals should be entertained only if there are adequate safeguards to protect the markets which AT&T may enter from cross-subsidy by the Bell System's monopoly services.

The degree of protection is a function of the degree of separation between AT&T's monopoly and its competitive operations. Accounting separation has proven to be ineffectual. Corporate separation can be effective only if outside competitors are given the same access to the facilities, the equipment, and the research and development activities of the monopoly parent as has the Bell System affiliate. Even then, competition will not be free of support from the monopoly parent unless the management, facilities, and most importantly, the marketing program are fully separated. Financial subsidy of the parent by the subsidiary can be prevented by a requirement for minority stock ownership by the public. Financial subsidy in the reverse direction, particularly through non-competitive purchases of the subsidiary's products or services by the monopoly parent, probably cannot be prevented short of a requirement for complete divestiture.

Senator HOLLINGS. Well, we thank you, Mr. Whitney and each of you.

We have another rollcall and by the time we get back over there, we will be preparing for a lunch appointment we have and another panel.

Each of you—does anyone differ with any of the statements made that you want to comment on? I didn't find too much difference.

Everybody wants to make darn sure A.T. & T. or any competitive entity that is truly competitive and is wholly owned is totally separated.

Mr. Jerritts, could that really disturb the corporate approach of those in the communications industry itself? Would they find that burdensome?

We are all enthused around to make sure this monopolistic carrier doesn't come in without being able to have a true accounting

and be totally separate and not subsidized, but then does that affect Honeywell?

You can go into all the different fields? If we pass a law that categorical, I can see corporations such as Honeywell having to divide up into wholly owned subsidiaries and get different directors and so forth.

Mr. JERRITTS. Our recommendation along those lines comes from the fact that we have had over many years extensive experience in being involved with 100 percent wholly owned subsidiaries, majority-owned subsidiaries and minority-owned and having minority equity positions in subsidiaries in other companies, both in the United States and on a worldwide basis.

Coming from the basic premise that what we are really talking about is the legislation would permit what are essentially dominant communications companies to enter a new field which is the total spectrum of data processing and communication processing, and the position those companies would start from—the \$50 billion equity bond financing kind of numbers—provides both a real and I imagine a perceived advantage that must be countered in some way to provide equity in a truly competitive area.

One way we would suggest you give serious consideration to is through the role of effective subsidiaries working on an arm's-length basis.

We would submit from this starting point the only way you are going to get effective arm's-length relationships, which really means effective management separation between the carrier and the new subsidiary involved in the new enterprise is through having it being responsible to a diverse body of shareholders.

Senator HOLLINGS. And different directors.

Mr. JERRITTS. Yes.

Senator HOLLINGS. When you come to complete divestiture, we have the House side—apparently they can't get sufficient support for that.

It's not that we don't know how to write a bill. It's that we don't know how to get one passed.

Mr. McGOWAN. May I suggest, I believe as time has gone by in this legislative process—specifically the several years in the House and also the time spent here—more light has been shed and more knowledge has been gained and more opinions, I think, are starting to be formed that telecommunications isn't such a mysterious animal as the people believed at the beginning.

I believe it has been to the telephone company's interest, for these many years, not to explain how the industry works. As people become aware of the industry's workings and its components and who makes it up and whom it influences and whom it affects, people are more willing to look at the possibility of restructuring.

I believe as developments come either out of court cases or from this committee—if it could find time to pursue more detailed knowledge of the conduct of various components of this industry—people will become less fearful of taking upon themselves what they might formerly have thought to be impossible.

Senator HOLLINGS. The fully separated entities between the local and exchange services, could you operate with the long-distance lines effectively without increasing prices?

Mr. McGOWAN. You would have a decreasing price. You would have the incentive for both parties—since they would be visible as to their operations—to be more effective.

Long distance, because they have competitors. Local telephone exchange, because you would be able to compare them with other local telephone exchanges.

Today, it is impossible to determine whether one city with 50,000 phones, whether one is served more efficiently or less efficiently than another city with 50,000 phones.

The comparison would be possible between local exchange carriers if their operations were fully separated from interchange carrier operations. The interface between the two types of carriers is very simple. People are trying to say it's complicated.

I interface every day in 30 States with local phone companies without difficulty. A.T. & T. does, too. For example, there is a company, C. & P., in the District of Columbia, that has no toll facilities. They meet with Bell's long lines at the toll offices. In their case, they sometimes colocate.

So, in effect, what they would do in a fully separated arrangement is have one party lease space to the other party. In my case today, I get as close to them as I can and I lease space at that point. So whether I lease that space from C. & P.—so as to colocate—from a building owner, which is what I do. Today, there is no real difference. In cities like Chicago, the local carrier owns the buildings which house some of the major toll offices. I happen to have three major toll offices in Chicago.

You meet between the local exchange company and the interexchange carrier at a toll office. Every time you pick up a phone and dial a number whose second digit is zero or one the local carrier's switch knows that you are placing a toll call.

So, the switch sends your call to a toll office. There the decision is made as to how to route that call. There is a complete distinct physical difference between a local exchange carrier and an interexchange carrier.

I believe that interface is so clear—for example, in Canada, there is a completely distinct entity called the TransCanada Network which operates all the toll system.

It happens that nine local telephone companies own that network. But it's a distinct operation. Distinct people, facilities, organization.

Everything is entirely separate. TransCanada handles all toll calls. They meet the local companies at the toll centers. Up there, the local carriers own and control it and, therefore, share in the revenues.

But local and long distance carriers can meet without any difficulty—in response to what Senator Goldwater asked earlier, we are going to submit a model that will demonstrate the physical, operational, technical, and financial methodologies to permit work as distinct entities from interexchange carriers.

Senator HOLLINGS. All right. I am sorry, I will have to move on and catch that vote as best I can.

I thank each of you.

The committee will be in recess until 2 o'clock.

[Whereupon, at 12:45 p.m., the hearing was recessed, to reconvene at 2 p.m., the same day.]

AFTERNOON SESSION

Senator HOLLINGS. We want to welcome the panel from A.T. & T. Mr. Olson, Mr. Tanenbaum, Mr. Ross, Mr. Preston, and Mr. Goldstein.

We will be glad to hear from you at this time, Mr. Olson.

STATEMENTS OF JAMES E. OLSON; MORRIS TANENBAUM; IAN ROSS; JOHN PRESTON; AND EDWARD GOLDSTEIN, AMERICAN TELEPHONE & TELEGRAPH CO.

Mr. OLSON. Thank you, Mr. Chairman.

We are very appreciative of the opportunity to appear before this subcommittee on behalf of A.T. & T. With me are four colleagues who have special expertise in key areas of our business.

As a panel, we are prepared to address in some detail the practical or technical aspects of the problems of S. 611 and S. 622.

Present for the Bell System is Morris Tanenbaum, president, New Jersey Bell Telephone Co. He has broad experience not only in the operational side of our business but in Bell Laboratories and Western Electric as well.

His testimony will deal specifically with the reasons why close working relationships among the Bell System units are so essential to an operating telephone company's ability to deliver good service to its customers and how certain of the bills' provisions might disrupt that service process.

Ian Ross is president of Bell Telephone Labs. He will discuss our technological innovation, which would be impaired if the close ties made possible by vertical and horizontal integration were to be disrupted.

John Preston, associate general counsel for A.T. & T., will address certain of the administrative legal and regulatory implications the Bell System sees in the two bills.

Finally, Edward Goldstein, assistant financial officer, A.T. & T. I know there was a great deal of discussion about new accounting systems and we thought it would be useful if you could hear from the man responsible for bringing that accounting system into being.

As these hearings have progressed, it has become clear that one of the wartiest issues to be addressed administratively will be that of potential cross-subsidization.

We agree with your objective and believe it's attainable. We can and must assure ourselves, our customers, regulators, and competitors that we know our costs and that noncompetitive services are not subsidizing competitive ones.

Mr. Goldstein's testimony will highlight our firm commitment in that regard.

In an effort to address the subsidy problem, S. 611 has in our view created barriers to the continued sound management of the Bell System. Earlier witnesses have expressed our general concern with the rigidly mandated establishment of fully separated subsidiaries and with the prescribed arm's length standard of inter-affiliate dealings.

Before the other panelists get into a detailed description of how the Bell System functions as a whole, let me raise a few of the kinds of specific questions which arise in reading those provisions.

It seems to me that under S. 611, unless the Bell System were willing to include all nonaffiliated entities in the pattern of its operations, the system could not have meetings of Bell System officers, legal conferences, engineering councils, or other activities among affiliates.

Reading S. 611 strictly, I question whether in the future the Bell System companies could jointly engage in research and development, the drafting of operating or engineering letters or even the development of company policy generally designed to further the planning and management of an affiliated system.

Potential application of this provision goes to employment and labor matters, including joint negotiations of contracts and personnel practices. It raises questions regarding the ability of one Bell System company to contract with another for research and product development unless the same services are provided to everyone else.

The list of questions continues with the fruits of the Bell System R. & D.; would they be proprietary or disclosed to the world? Could A.T. & T. furnish legal advice to affiliates or could it do so only if it furnished legal advice to IBM and MCI as well?

What of financial planning? In short, it seems if the purpose of these provisions is to insure fair dealings in the marketplace, the bill ought to focus on the marketplace presence of the Bell companies and not fracture relationships at other levels, relationships which are essential to the operations of this largely technical business.

To understand better the extent of the Bell System's concern with these provisions and reasons for that concern, let me urge you to listen to the testimony here with these kinds of questions in mind.

Another provision which we view as unnecessarily interfering with the management of the business is the prescription under sections 104(11) and 214(b)(1), prohibiting certain classes of people from corporate boards of directors.

Those provisions would require the resignations of nearly all of the men and women currently serving on the boards of Bell System companies.

Further, it would disqualify from future membership on these boards a substantial majority of all of those people most qualified by reason of training and experience to direct the affairs of a large and technically complex corporation.

This provision should be stricken from the bill. Now, with your permission, Mr. Chairman, I would like to ask each of my colleagues to present a brief summary of their testimony that has been filed with the subcommittee.

Following this, we will be most happy to sit as a panel for any questions you may have.

If that's permissible, we will go ahead.

Senator HOLLINGS. Very good. You don't really think the bill requires you to give legal advice to IBM?

Mr. OLSON. This is the concern we have in trying to read what you mean by arm's length dealings and fully separated subsidiaries.

Senator HOLLINGS. Just exactly what it says. That the legal advice be given to the wholly owned subsidiary by the wholly owned subsidiary lawyer. You can't even divorce your mind from that kind of thinking, is that right?

The only way you can see it is that Bell will still be there and no way to have a wholly owned subsidiary?

Mr. OLSON. Yes, I think there is a way of having that. We have many of those today.

Senator HOLLINGS. Under no circumstances does the bill contemplate the A.T. & T. lawyers be giving IBM legal advice.

Mr. OLSON. Our concern was the literal interpretation of the bill at least as we understand it, and I think that is something we certainly want to have clarification on.

If you read it literally, at least it's our feeling that we would have to deal at arm's length with the wholly owned subsidiaries and arm's length has to be interpreted in a way that says we perhaps might have to deal with our subsidiaries in the same way we would deal with nonaffiliates.

We hope that isn't the intent.

Senator HOLLINGS. Go ahead with the other witnesses.

Mr. OLSON. Dr. Tanenbaum.

DR. TANENBAUM. Mr. Chairman, Senator Schmitt, members of the committee staff, I echo Mr. Olson's appreciation for the opportunity to appear before you to comment on S. 611 and S. 622.

Although my testimony will focus on selected aspects of the legislation which are of particular concern to me, I don't want that to obscure my sincere appreciation of your interest and willingness to address the complex issues whose resolution will determine the future of telecommunications in the United States.

I will do the best I can to try to add to the information that you will use to reach your decisions. The background from which I speak was mentioned by Mr. Olson and is presented in detail in my printed testimony.

It's from my personal experience at Bell Labs, Western Electric, A.T. & T. and Jersey Bell, that I will try to set forth what I see as the potential effects of proposed legislation on the Bell System, on individual operating telephone companies and on the telecommunications industry and, indeed, the Nation as a whole.

I recognize that neither of the Senate bills under consideration explicitly mandates divestiture of Bell Laboratories, Western Electric or any of the operating telephone companies from the Bell System or destroying the ownership ties between these units. Indeed, S. 622 prohibits divestiture by the FCC.

But the cumulative impact of certain provisions of S. 611 could have the same effect as divestiture from the viewpoint of innovation and the effective operation of the telecommunications network.

Sections 205, 206, and 207, as they might be construed, could require fully separated subsidiaries to provide various classes of service.

These subsidiaries would have no common directors, no common officers, no common employees, no common financial structure and no commonly owned facilities.

They would also be constrained to act at arm's length, which I assume means that they could not exchange information openly among themselves without making such interchange publicly available.

Sections 205, 206 and 207 would not only require major changes in the way nationwide and international telecommunications service is provided today, but depending on how the arm's-length requirements are interpreted, could also have the de facto result of fragmenting the critical information flows and planning procedures of the Bell System.

My fundamental thesis, Mr. Chairman, is that the technological and operating structure of the Bell System is essential to this Nation's continuing position as the uncontested world leader in telecommunications. That structure is neither arbitrary nor is it a relic of earlier, outdated conditions.

It is most important to appreciate that this association of Bell Laboratories, Western Electric, the operating telephone companies, the long lines department of A.T. & T. and the A.T. & T. general departments is structured to serve the technological imperatives of the network—not the other way around.

Legislation or other action that would artificially distort the structure or substantially change the working relationships between the elements could create a mismatch that could impede the future evolution of the network and threaten our Nation's leadership position.

It is axiomatic in the management of research and development that the creative acts of discovery and invention are but the first steps in the long chain of events that result in technological innovation—the total process of bringing scientific knowledge to public use.

The literature of management is filled with case histories of discoveries that lay fallow for years, until they were finally developed into useful products or services.

The key element in completing the innovative chain is often referred to as coupling—the process of bringing together in a single mind or group of minds the knowledge of discovery, the understanding of the need and the vision of how the two can be integrated.

The problem is not trivial nor irrelevant to your deliberations. The basic research scientist is often so fully occupied with pressing forward the frontiers of knowledge that he is unaware of the opportunities of the market or the detailed needs of the operating organization.

Conversely, the marketing or operating person is usually so engaged with day-to-day needs that he is unfamiliar with or unable to understand the latest advances in science. The principal task of technical management is to bridge these natural barriers between differing talents and differing interests.

In a technology-intensive industry, the organizations which meet the challenge best are the ones that survive and prosper.

The coupling of knowledge and need is a challenge in any technologically based industry. It is even more demanding in telecommunications, where the compatibility imperatives of the network introduce additional parameters that new technology must meet.

Thus the discovery of a property of matter that leads to a new device such as the transistor or the laser must not only lead to a cost savings or to a new service that meets a market need, but it must also be built into a system that will work with the existing network.

That is the heart of technological integration—the ability to bring together basic research, invention, development, marketing, manufacture, and operation in an atmosphere that stimulates the most open exchange of knowledge and information.

If the process is to work, it must be free of proprietary and trade secret barriers.

It must be unencumbered by parochial interests and driven by a common mission.

Dr. Ross will describe in more detail the critical need for such unimpeded flows of information in developing the sophisticated products of modern telecommunications and in planning the services that such products make possible.

I cannot overemphasize that artificial barriers and arm's-length relationships between research and development, manufacturer and operations will drastically impede the ability to innovate, with undesirable consequences for telecommunications.

The telecommunications network, with its sophisticated architecture and geographical dispersion, is infinitely more complex than the largest general purpose computer. At the same time, its services must be finely honed to the needs and desires of the individual consumer. Thus the case for technological integration in telecommunications is greater than in any other area of which I am aware.

Such integration is practiced by the more successful telephone administrations in other countries such as Japan, Sweden, and Canada.

A recent study entitled "Telecommunications in Canada" stated:

Experience in many other countries has demonstrated the advantages of vertical integration in this field, and the committee is of the opinion that the Bell/Northern Telecom complex is of striking advantage for Canada and an essential base for any kind of Canadian technological sovereignty.

Bell Canada is Canada's largest telephone utility, and Northern Telecom is Canada's largest manufacturer of telecommunications equipment—61 percent owned by Bell Canada and supplying according to Government estimates, at least 75 percent of Bell Canada's equipment requirements. Northern Telecom is also very active and successful in the U.S. telecommunications equipment market.

To this point, I have addressed the issues of the vertically and technologically integrated structure of the Bell System and the need to preserve the day-to-day working relationships that are the essence of technological integration.

However, as I have indicated, there is another facet of integration that must be considered; namely, horizontal or operational integration. It complements technological integration and is inseparable from it.

By operational integration, I mean the interaction among Bell System and independent operating telephone companies and long lines that is designed to provide, continuously maintain, and enhance telecommunications services demanded by the public.

Last week, Mr. Chairman, you heard Mr. Robert Sageman of the long lines Department of A.T. & T. address the benefits, economies and efficiencies that are realized by using common transmission and switching facilities, planning, operational and administrative procedures to provide both intraexchange and interexchange services.

These facilities and their management are not separate, isolated piece-parts of separate networks, but rather are woven inextricably into the very fabric of the nationwide core network.

Mr. Sageman described the network and its ability to make millions of billions of possible connections between hundreds of millions of customers.

He also described the importance of operational integration in responding to major emergencies. In addition to catastrophic events that make national headlines, other emergencies occur, affecting smaller numbers of customers, but requiring the same degree of control and coordination that we marshal to meet wide-scale disasters.

I describe some of these in my filed testimony.

In both cases service was restored in 1 or 2 days.

The user expects the telecommunications network to provide—on demand—high quality, reliable communications links between desired locations. To the customer originating a call, the boundaries of local and toll service are indistinguishable from the viewpoint of service.

The division of messages into local and interexchange categories is important for billing purposes, but not for communication purposes.

The customer should not—does not want to—be burdened by how a call is connected or what companies are involved in making the connection.

The American public simply has insisted that it happen, and the Bell System and independent telephone companies work to make it happen in the most efficient manner possible.

In New Jersey Bell and the other operating telephone companies, both the connecting lines between switching centers and the centers themselves are designed to accommodate calling patterns established by the communities of interest of our customers.

As customers' interests change, the network patterns change. They do not follow the patterns of standard metropolitan statistical areas—SMSA's—which have been drawn for entirely different reasons.

The same physical facilities are often used for both interexchange and intraexchange purposes.

In New Jersey there are approximately 250 local switching units. Over 200 of them—or more than 80 percent—are used for both local exchange and interexchange purposes, based on the definition in section 226 of S. 611.

In addition, we have 23 toll units, 17 of which also have the ability to complete calls within the local exchange area.

I could not, in the time available, make a comparable study of the disposition of transmission links, since local loops, intraexchange trunks and interexchange trunks frequently are found in the same cable sheath.

Thus, in planning our network facilities, considerations as to what constitutes intraexchange calling, as opposed to interexchange calling, are basically irrelevant.

I am also very much concerned, Mr. Chairman, that those provisions of S. 611 that would force a separation between interexchange and intraexchange services and facilities would make it extraordinarily difficult—if not impossible—for a customer whose operations are widespread geographically to find a single source of expert counsel on the network architecture that would provide a systems solution to his telecommunications problems and needs.

Similarly, the separation between category II carriers and the sale or lease of telecommunications equipment would make it impossible for any customer to obtain a complete service—even the most basic—from a single provider without special findings by the Commission.

Thus, all customers could be compelled to adopt a piecemeal and piece-part approach to problems and needs that can be resolved most efficiently through the systematic and systemic application of telecommunications solutions.

I have another concern about this matter. In an environment of disaggregated and, possibly, discrete networks, who would ultimately be responsible for assuring continuity of service in the event of a system failure?

There is still another aspect of operational integration that warrants discussion—the management of the nationwide telecommunications network. Mr. Sageman has described how network management works on a national scale, permitting calls to be rapidly rerouted for peak holiday traffic or in cases of emergency and catastrophe. On the State level, we manage the network in a similar and compatible way.

Just as A.T. & T. long lines has a national network management center, we in New Jersey have a statewide network management center that monitors and controls traffic for that portion of the network for which we are directly responsible.

Our center has a group of long lines personnel on permanent assignment to it. It is built to the same standards and specifications as the long lines center and those of the other operating telephone companies. Thus, the centers are tied together and can communicate automatically or through the intervention of their managers.

This compatibility of equipment, procedures, and training of the operations people is essential to efficient use of the network, especially in times of crisis when arm-in-arm teamwork is particularly critical and local areas or even large parts of the Nation become critically dependent on communications.

The purpose of my testimony has been to demonstrate the benefits to the customer of a technologically and operationally integrated structure in telecommunications.

We are not wedded to the past, Mr. Chairman, although we are proud of the industry's accomplishments.

Our concern is the future of telecommunications in the United States. We have in this country a telecommunications system that is the envy of the world.

An understanding of how we reached our present preeminence, combined with our knowledge of the existing network and our best vision of how it can evolve to serve the needs of the future, is essential, as we probe for a consensus as to what structural changes or accommodations may be necessary to assure the people of our country that 10 years, 25 years, 50 years from now the United States will have a telecommunications system that will still be the standard by which the rest of the world measures its performance.

And we stand ready, Mr. Chairman, to help the Congress of the United States develop a telecommunications policy that will be prospectively oriented—one that will help promote a greater diversity of suppliers, a broader variety of consumer choices, a healthy market environment in which all suppliers, carriers, and manufacturers will be able to compete fairly and equitably.

I believe we can accomplish that, Mr. Chairman, while at the same time—as Mr. Brown said in his testimony last week—“retain- ing, and indeed enhancing, the universal service objective.”

Thank you very much.

[The statement follows:]

STATEMENT OF MORRIS TANENBAUM ON BEHALF OF AMERICAN TELEPHONE & TELEGRAPH CO.

My name is Morris Tanenbaum and I am President of New Jersey Bell Telephone Company with headquarters in Newark, New Jersey.

I joined the Bell System in 1952 as a member of the Research Division of Bell Laboratories after receiving a Ph.D. in Physical Chemistry from Princeton University. In addition to working as a scientist and engineer, I have held a number of management positions at Bell Laboratories, including the position of Executive Vice President for Systems Engineering and Development.

I was with Western Electric for ten years, where I held the positions of Director of Research and Development, Vice President of Engineering and Vice President of Manufacturing—Transmission Equipment.

From 1976 until July of last year, when I assumed my present position, I served as Vice President of Engineering and Network Services of the American Telephone and Telegraph Company.

During my career I have served on advisory committees at a number of universities and I am currently on the Boards of Trustees of Tufts University, Worcester Polytechnic Institute, and on the Board of Governors of Rutgers—The State University of New Jersey. I have also served on a variety of advisory committees to the Federal Government. I am a member of the National Academy of Engineering and its Council, and have served as a member of the Governing Board of the National Research Council and member of the Industrial Research Institute. As a result, I have many professional associations with scientists and engineers in academic, governmental and industrial research, development and production organizations. I have visited many such organizations in this country, in Western Europe and in the Orient.

I appreciate this opportunity to appear before the Subcommittee to discuss the current integrated nature of the telecommunications industry and to set forth what I see as the potential effects of the legislation under discussion on the Bell System, on an individual Operating Telephone Company, on the telecommunications industry and on the Nation as a whole.

I recognize, Mr. Chairman, that neither of the Senate bills under consideration explicitly mandates divestiture of Bell Laboratories, Western Electric or any of the Operating Telephone Companies from the Bell System or destroying the ownership ties between these units. Indeed, S. 622 prohibits divestiture by the Federal Communications Commission.

But the cumulative impact of certain provisions of S. 611 could have the same effect as divestiture from the viewpoint of innovation and the effective operation of

the telecommunications network. Sections 205, 206 and 207, as they might be construed, could require fully separated subsidiaries to provide various classes of service. These subsidiaries would have no common directors, no common officers, no common employees, no common financial structure and no commonly owned facilities. They would also be constrained to act at arms length which I assume means that they could not exchange information openly between themselves without making such interchange publicly available. Sections 205, 206 and 207 would not only require major changes in the way nationwide and international telecommunications service is provided today, but depending on how the arms-length requirements are interpreted, could also have the de facto result of fragmenting the critical information flows and planning procedures of the Bell System and would effectively vitiate the benefits of the vertical and horizontal relationships between Western Electric, Bell Laboratories, the Operating Telephone Companies and the Long Lines Department of AT&T. We believe those relationships are essential to telecommunications progress in our country and to the ability of the United States to maintain its world leadership across the broad spectrum of telecommunications technology.

As you have seen by my professional background, I have worked for the principal units of the Bell System responsible for technology and, in my present role as President of New Jersey Bell, I have had the opportunity to see first-hand the operational advantages of a vertically and horizontally integrated enterprise focused on the telecommunications needs and expectations of our customers and the nation.

My fundamental thesis, Mr. Chairman, is that the technological and operating structure of the Bell System is essential to this Nation's continuing position as the uncontested world leader in telecommunications. That structure is neither arbitrary nor is it a relic of earlier, outdated conditions. It is instead a living, continuously evolving arrangement of elements that reflects our best efforts to conceive, develop, install and operate an efficient and modern telecommunications network. It is most important to appreciate that this association of Bell Laboratories, Western Electric, the Operating Telephone Companies, the Long Lines Department of AT&T and the AT&T General Departments is structured to serve the technological imperatives of the network—not the other way around. Legislation or other action that would artificially distort the structure or substantially change the working relationships between the elements could create a mismatch that could impede the future evolution of the network and threaten our Nation's leadership position.

At the same time we understand and share your desire to assure "... creativity, technological and service innovation, responsiveness to consumer need, operating efficiencies ...". We respect your desire for selective deregulation and increased competition. However, as Mr. Olson has testified, we believe that those objectives can be achieved without massively disrupting the working relationships within the Bell System that have served the Nation so well in the past and promise to be even more vital in the future.

My testimony will endeavor to explain our concern and why we believe that the issues you are addressing are so important. I will first describe briefly the major elements of the Bell System. Next I will address the area of technological innovation and then the area of operations. My testimony will supplement the testimony you will hear shortly from Dr. Ian Ross as well as the testimony presented last week by Mr. Robert Sageman, but in both cases I will endeavor to provide the perspective of one who has personal experience in research and development, manufacturing and operations. While the combination of these three functions is commonly known to economists as vertical integration, I will focus on the aspect that I believe is most compelling in telecommunications, namely, technological integration.

Bell System structure

The Bell system is comprised of the AT&T General Departments, Bell Telephone Laboratories, Western Electric and the Operating Telephone Companies in which I also include the Long Lines Department of AT&T.

AT&T, as the parent organization, provides policy as well as detailed day-to-day guidance in the development of technology and customer services. The General Departments of AT&T assure the Bell System's ability to meet emerging customer needs by bringing together—in one place—the service and technological requirements of the Operating Telephone Companies, a detailed knowledge of present technology, and an in-depth understanding of the potential of future technology. All major new technological projects are undertaken under the general guidance of these headquarters groups.

The fundamental mission of the Bell Laboratories is to assure that the Bell System will have available the knowledge and technology essential to meeting the Nation's current and future communications needs.

Even though Bell Laboratories is most often thought of as a research organization, basic research accounts for only about 13 percent of its total effort. The bulk of its activities are devoted to engineering and detailed design. All of Bell Laboratories' activities are guided by its systems engineers, who match telephone company needs with the opportunities arising out of new technology.

Western Electric is the Bell System's manufacturing and supply unit, and as such is managed solely for and in the interest of the Operating Telephone Companies. Western Electric frequently is viewed only as a manufacturer. It is important to this discussion, however, to recognize that Western Electric carries out a host of other essential functions for the Operating Telephone Companies and is closely involved with the work of Bell Laboratories as well.

Long Lines is the operating arm of AT&T. It coordinates and participates in the construction, maintenance and operation of the long distance network that interconnects Bell as well as Independent telephone companies. In effect, Long Lines serves as a "managing partner"—coordinating the growth of the interstate network as its facilities and routes are continually reconfigured according to an overall technical master plan.

The 23 Bell Operating Telephone Companies concentrate on local and regional service needs. Let me point out, however, that the basic mission of the Operating Telephone Company—to meet the public's demand for the widest availability and diversity of high quality telecommunications services at the lowest possible cost—is the same mission that sets the goals and dictates the activities of all units of the Bell System.

Technological innovation

With that brief description, let me turn now to technical innovation in telecommunications. In his testimony last week, Mr. Sageman described the "core" network and the demanding compatibility requirements of the physical and administrative systems that enable it to operate. These requirements place great disciplines and demands on the introduction of new technology and new services. The large investment embedded in the present network—an investment provided by 3,000,000 share owners and the savings of millions of others—makes it economically necessary that new technology be compatible with the embedded technology. Of greater importance, the Nation's minute-to-minute dependence on the network makes it imperative that modern equipment embodying new technology not disrupt the ability of the network to function.

It is axiomatic in the management of research and development that the creative acts of discovery and invention are but the first steps in the long chain of events that result in technological innovation—the total process of bringing scientific knowledge to public use.

The literature of management is filled with case histories of discoveries that lay fallow for years until they were finally developed into useful products or services. The key element in completing the innovative chain is often referred to as "coupling"—the process of bringing together in a single mind or group of minds the knowledge of discovery, the understanding of the need and the vision of how the two can be integrated.

The problem is not trivial nor irrelevant to your deliberations. The basic research scientists is often so fully occupied with pressing forward the frontiers of knowledge that he is unaware of the opportunities of the market or the detailed needs of the operating organization. Conversely, the marketing or operating person is usually so engaged with day-to-day needs that he is unfamiliar with or unable to understand the latest advances in science. The principal task of technical management is to bridge these natural barriers.

There have been many organizational experiments designed to improve that process and many texts written about it. At the heart of all these considerations is the clearly perceived need to break down communications barriers between the generators of new knowledge and the ultimate users of the fruits of that knowledge. In a technology-intensive industry, the organizations which meet the challenge best are the ones that survive and prosper.

The coupling of knowledge and need is a challenge in any technologically based industry. It is even more demanding in telecommunications where the compatibility imperatives of the network introduce additional parameters that new technology must meet. Thus, the discovery of a property of matter that leads to a new device such as the transistor or the laser must not only lead to cost savings or to a new service that meets a market need, but it must also be built into a system that will work with the existing network.

That is the heart of technological integration—the ability to bring together basic research, invention, development, marketing, manufacture and operation in an atmosphere that stimulates the most open exchange of knowledge and information.

If the process is to work, it must be free of proprietary and trade secret barriers. It must be unencumbered by parochial interests and driven by a common mission. The Bell System's success in advancing network technology—the envy of every other nation in the world—is based on the successful practice of technological integration.

May I illustrate the process of technological integration from my own experience in the Bell System. In my first assignment at Bell Laboratories, I studied the basic properties of semiconductors, the materials from which transistors and integrated circuits are made.

My personal drive at that time basically was to understand how semiconductors achieve their unique properties, but because of my frequent interactions with device engineers literally down the hall, I knew that if certain properties could be understood and enhanced, better transistors could be made.

Later I worked in a group dedicated to the invention of new semiconductor devices where I not only heard immediately about any new property that was discovered in research but also knew what kinds of devices the systems designers needed to improve telephone equipment.

Still later working in systems development and engineering, we had a complete knowledge of what existed in the network since we had designed it and determined its specifications. Thus, we were intimately aware of the constraints that new technology must satisfy if it were compatible with and work in the network. In addition, I had open and frequent contact with AT&T and the Operating Telephone Companies, with access on a daily basis to emerging field problems and marketing opportunities and plans.

During my period with Western Electric, I had an open "corridor" to the research and engineering results and planning at Bell Laboratories so that I could anticipate the future products that would be specified and could explore and develop the manufacturing processes that would be needed to produce them. This greatly shortened the time-interval required to bring a new discovery into use. I also knew of the Operating Telephone Companies' plans to market new services that would determine when new products had to be available and in what quantities.

And with AT&T and now with New Jersey Bell, I have observed the final, ultimate link in the chain—the places where service to the public is planned and delivered. It is from these positions that guidance is provided to the technological innovation process as a whole and where the results of that process are finally integrated into the network and tested in the public marketplace.

Dr. Ross will describe in more detail the critical need for such unimpeded flows of information in developing the sophisticated products of modern telecommunications and in planning the services that such products make possible. I cannot overemphasize that artificial barriers and arms-length relationships between research and development, manufacture and operations will seriously impede the ability to innovate, with undesirable consequences for telecommunications and for the Nation.

Technological integration by others

As I have noted, the importance of the coupling between discovery and needs that we have achieved through technological integration is well understood in the most successful technologically based industries such as IBM, G.E., Xerox, Texas Instruments and Others.

In the early days of electronic computers, IBM purchased the semiconductor devices they needed from vendors. However, they soon realized that it would be essential for them to have better control of the technology of the devices they used if they were to control their corporate destiny in the rapidly changing technology of data processing. Thus, they established over 15 years ago a design and manufacturing facility for semiconductor devices. In effect, they extended their level of technological integration to a more fundamental level.

More recently, Texas Instruments, a premier innovator in semiconductor electronics, realized that even with respect to relatively simple consumer products such as hand calculators and electronic watches, they had to design and market the finished products in order to gain full advantages of their device capabilities. Thus, they extended their level of technological integration to the completed consumer product.

The telecommunications network, with its sophisticated architecture and geographical dispersion, is infinitely more complex than the largest general purpose computer. At the same time, its services must be finely honed to the needs and desires of the individual consumer. Thus the case for technological integration in telecommunications is greater than in any other area of which I am aware.

Such integration is practiced by the more successful telephone administrations in other countries such as Japan, Sweden, and Canada. Though the industry structure in Japan is rather different from ours, the practical results of their structure are similar. In Sweden, the administration owns a manufacturing organization that supplies an important part of the administration's equipment needs.

You may also be aware of a recent study entitled, "Telecommunications in Canada", whose results were reported in March of this year. The study was conducted by a committee charged by the Minister of Communications in November of 1978 to examine—among other aspects of telecommunications in Canada—"... a strategy to restructure the Canadian telecommunications system to contribute more effectively to the safeguarding of Canada's sovereignty...". Among its findings the Committee stated, "The Restrictive Trade Practices Commission is at present conducting an enquiry into the telecommunications supply industry in Canada; should the commission recommend that Bell Canada divest itself of effective ownership of Northern Telecom so as to promote more competition in the subsector, there is a strong probability that, because of the peculiar structure of the industry in Canada, most of the competition would be provided by foreign interests. Experience in many other countries has demonstrated the advantages of vertical integration in this field, and the Committee is of the opinion that the Bell/Northern Telecom complex is of striking advantage for Canada and an essential base for any kind of Canadian technological sovereignty."

Bell Canada is Canada's largest telephone utility, and Northern Telecom is Canada's largest manufacturer of telecommunications equipment—61 per cent owned by Bell Canada and supplying, according to government estimates, at least 75 per cent of Bell Canada's equipment requirements.

I should note, Mr. Chairman, that although their origins were closely related, there has been no affiliation between Bell Canada and the Bell System for several years.

The advantages and performance of technological integration have also been studied and evaluated by distinguished academicians. Professor Harvey Brooks, Benjamin Pierce Professor of Technology and Public Policy at Harvard has long been a student of the processes of technological innovation. Former Chairman of the Committee on Science and Public Policy of the National Academy of Sciences, he has often testified before Congress. In an article entitled, "Knowledge and Action: The Dilemma of Science Policy in the 70's", Professor Brooks stated: "The Bell System represents the best example of a highly integrated technical structure in a high technology industry and is widely regarded as the most successful and innovative technical organization in the world."

Horizontal integration

To this point, I have addressed the issues of the vertically and technologically integrated structure of the Bell System and the need to preserve the day-to-day working relationships that are the essence of technological integration. However, as I have indicated, there is another facet of integration that must be considered: namely, horizontal or operational integration. It complements technological integration and is inseparable from it.

By operational integration, I mean the interaction among Bell System Operating Telephone Companies and Long Lines that is designed to provide, continuously maintain, and enhance telecommunications services demanded by the public.

Last week, Mr. Chairman, you heard Mr. Robert Sageman of the Long Lines Department of AT&T address the benefits, economies and efficiencies that are realized by using common transmission and switching facilities, planning, operational and administrative procedures to provide both "intraexchange" and "interexchange" services. These facilities and their management are not separate, isolated piece-parts of separate "intraexchange" or "interexchange" networks but rather are woven inextricably into the very fabric of the nationwide core network.

That core network is constantly growing, changing and improving—while continuing to operate. With this complex, dynamic and continuously evolving network, the responsibility for its planning, construction, operation, maintenance and management must be an integrated process—with primary emphasis on transmission and switching capabilities, compatibility and efficiency. Mr. Sageman described the network and ability to make millions of possible connections between hundreds of millions of customers. He also described the importance of operational integration in responding to major emergencies. In addition to catastrophic events that make national headlines, other emergencies occur, affecting smaller numbers of customers, but requiring the same degree of control and coordination that we marshal to meet widescale disasters.

Let me describe—from my perspective as president of New Jersey Bell—two such incidents that further illustrate the true value of the Bell System's horizontally integrated structure.

Madison, N. J.—Flood

On Saturday, August 28, 1971, tropical storm Doria swept through New Jersey leaving Main Street in Madison and our local central office completely flooded. This

central office, which served more than 19,000 telephones, stopped processing calls at about 5:15 a.m. By 11:45 a.m. the next day, service was fully restored. A completely new, temporary power plant, consisting of batteries, charging equipment, ringing generators, and an emergency power generator was collected from various points in the country and assembled in about 30 hours.

New Jersey Bell engineers had determined the necessary component parts and contacted Western Electric to arrange for materials and installers to be at the scene. Even before the water was completely removed from the power room, material had been delivered. The emergency power generator and one emergency ringing generator were provided by New Jersey Bell Telephone Company. New York Telephone supplied an additional emergency generator. Batteries and rectifiers were procured by Western Electric, which diverted shipments from other locations in New Jersey. Rectifiers were also obtained from Ohio.

The significance here is that the technical and operational compatibility within the network allows the Bell System to react quickly in emergency situations. In this case, no special drawings were required, no documentation had to come with the equipment—commonality of purpose is all pervasive, affecting the standardization of equipment and components and allowing for the expeditious shipment of manpower and material from one, two or several Bell System companies to another.

In addition, the arm-in-arm partnership of the Operating Telephone Companies and Western Electric permitted immediate action without contractual and financial negotiations.

Piscataway repeater hut fire

Allow me to cite just one more example. On October 18, 1974, a repeater hut in Piscataway, New Jersey, was destroyed by fire. A repeater hut is a small building that contains the electronic equipment needed to amplify and control volume levels at acceptable grades of quality—an integral component of the transmission path. The hut contained 182 carrier systems of both Long Lines and New Jersey Bell, involving 1,700 message trunks and more than 1,000 special services—some involving the highest priority for national security.

New Jersey Bell, in concert with Long Lines, immediately implemented network management controls to reroute traffic and reestablish critical service. When the fire was brought under control, the equipment was inspected and declared unusable. A.T. & T., working with New Jersey Bell, determined that seven carrier vans, owned by Pacific Telephone and Telegraph, were available for use in this situation.

Pacific Telephone arranged to transport the vans from four locations in Northern California to Travis Air Force Base. They were loaded and on their way to New Jersey on the afternoon of October 19th, the day after the fire. In addition, Pacific Telephone sent two technical experts, familiar with the van equipment, to assist us in restoring service. The first system was turned up for service 24 hours after leaving California. This interchange of equipment and personnel was made possible by the technical compatibility and horizontal integration of the Bell System.

These are but two local examples of unusual events that involved my Company directly. Mr. Sageman reported others. The same degree of integration and cooperation that is brought to bear during disasters and emergencies is fundamental to our ability to deliver services to our customers day in, day out.

Integration of intraexchange and interexchange services

The user expects the telecommunications network to provide—on demand—high quality, reliable communications links between desired locations. To the customer originating a call, the boundaries of local and toll service are indistinguishable from the viewpoint of service. The division of messages into local and interexchange categories is important for billing purposes, but not for communications purposes.

The customer should not—does not want—to be burdened by how a call is connected or what companies are involved in making the connection. The American public simply has insisted that it happen, and the Bell System and Independent telephone companies work to make it happen in the most efficient manner possible.

In New Jersey Bell and the other Operating Telephone Companies, both the connecting lines between switching centers as well as the centers themselves are designed to accommodate calling patterns established by the communities of interest of our customers. As customers' interests change, the network patterns change. They do not follow the patterns of Standard Metropolitan Statistical Areas (SMSAs), which have been drawn for entirely different reasons and which generally are changed every ten years following the National Census. Our interoffice trunking patterns are reviewed annually and changed continuously.

The pattern of the network must follow the interests of the people it serves. Even when geographical lines are drawn based on state boundaries—as they are in New Jersey—they must be bridged by planning teams, day-by-day operational arrange-

ments and financial agreements that encourage—as Mr. Sageman has put it—arm-in-arm teamwork, not arm's-length negotiation.

In addition, as Mr. Sageman has also pointed out, the same physical facilities are often used for both interexchange and intraexchange purposes. In New Jersey there are approximately 250 local switching units. Over 200 of them—or more than 80%—are used for both local exchange and interexchange purposes (based on the definition in Section 226 of S. 611). In addition, we have 23 toll units; 17 of which also have the ability to complete calls within the local exchange area. I could not, in the time available, make a comparable study of the disposition of transmission links, since local loops, intraexchange trunks and interexchange trunks frequently are found in the same cable sheath.

Thus, in planning our network facilities, considerations as to what constitutes “intraexchange” calling as opposed to “interexchange” calling are—basically—irrelevant. New Jersey Bell is not unique in this respect.

I am also very much concerned, Mr. Chairman, that those provisions of S. 611 that would force a separation between interexchange and intraexchange services and facilities would make it extraordinarily difficult—if not impossible—for a customer whose operations are widespread geographically to find a single source of expert counsel on the network architecture that would provide a systems solution to his telecommunications problems and needs. Similarly, the separation between Category II carriers and the sale or lease of telecommunications equipment would make it impossible for any customer to obtain a complete service—even the most basic—from a single provider without special findings by the Commission. Thus all customers could be compelled to adopt a piece-meal and piece-part approach to problems and needs that can be resolved most efficiently through the systematic and systemic application of telecommunications solutions. As you know, Mr. Chairman, it is a well-recognized management principle that when one attempts to optimize the performance of the individual piece-parts of a system it generally results in suboptimizing the performance of the system as a whole.

I have another concern about this matter. In an environment of disaggregated and, possibly, discrete networks, who would ultimately be responsible for assuring continuity of service in the event of a system failure?

Network management

There is still another aspect of operational integration that warrants discussion—the management of the nationwide telecommunications network. Mr. Sageman has described how network management worked on a national scale, permitting calls to be rapidly rerouted for peak holiday traffic or in cases of emergency and catastrophe. On the state level, we manage the network in a similar and compatible way. Just as AT&T-Long Lines has a National Network Management Center, we in New Jersey have a state-wide Network Management Center that monitors and controls traffic for that portion of the network for which we are directly responsible. Our Center has a group of Long Lines personnel on permanent assignment to it. It is built to the same standards and specifications as the Long Lines Center and those of the other Operating Telephone Companies. Thus the centers are tied together and can communicate automatically or through the manual intervention of their managers. This compatibility of equipment, procedures and training of the operations people is essential to efficient use of the network, especially in times of crisis when arm-in-arm teamwork is particularly critical and local areas or even large parts of the Nation become critically dependent on communications.

CONCLUSIONS

The purpose of my testimony has been to demonstrate the benefits to the customer of a technologically and operationally integrated structure in telecommunications.

There is no dispute that the telephone system in this country is the best in the world. I have just returned from an investment mission to Great Britain and Germany led by Governor Byrne of New Jersey. My purpose was to answer any questions foreign companies might have regarding communications in New Jersey. While I was able to enlighten our audiences as to the variety and power of the new services we provide, and that are not available abroad, I found it unnecessary to speak about quality, availability or price. It is well known to the businessmen with whom I spoke that service and cost in the United States, both in business and in the home, are superior to those found anywhere in the world—including their own countries. In addition, in this country the cost of telephone service has increased at a significantly lesser rate than the cost of other goods and services.

That did not happen by accident. The vertical and horizontal structure of the Bell System evolved naturally as the means to achieve the goals I defined earlier: the rapid, efficient introduction of innovative technology to provide the widest availabil-

ity and diversity of telecommunications services and at the lowest overall cost to the entire public. In a very real sense, Mr. Chairman, the needs of the public combined with the opportunities of technology—and the compatibility requirements of the network—have defined the structure of the Bell System.

In light of the Bell System's performance record and the repeated recognition over the years of the benefits flowing from its technologically and operationally integrated structure, the structure of the Bell System is a matter of national significance. It affects the infrastructure of our society and has ramifications for prosperity, employment, national defense and our country's position in the world.

We are not wedded to the past, Mr. Chairman, although we are proud of the industry's accomplishments. Our concern is the future of telecommunications in the United States. We have in this country a telecommunications system that is the envy of the world. An understanding of how we reached our present preeminence combined with our knowledge of the existing network and our best vision of how it can evolve to serve the needs of the future is essential as we probe for a consensus as to what structural changes or accommodations may be necessary to assure the people of our country that 10 years, 25 years, 50 years from now the United States will have a telecommunications system that will still be the standard by which the rest of the world measures its performance.

And we stand ready, Mr. Chairman, to help the Congress of the United States develop a telecommunications policy that will be prospectively oriented—one that will help promote a greater diversity of suppliers, a broader variety of customer choices, a healthy market environment in which all suppliers, carriers and manufacturers will be able to compete fairly and equitably. I believe we can accomplish that, Mr. Chairman, while at the same time—as Mr. Brown said in his testimony last week—"retaining, and indeed enhancing, the universal service objective."

Thank you very much.

Senator HOLLINGS. Who is next?

Mr. OLSON. Dr. Ross.

Mr. ROSS. I, too, appreciate the opportunity to be here today. The purpose of my testimony is to describe technical integration in the Bell Laboratories and Bell System and to explain how the capability could be impaired by the legislation pending before the Senate.

In my view, certain sections of this legislation could disrupt the Bell System's technical integration and impede the flow of new technology into the telecommunications network.

This could deprive the public of valuable new services and economies.

The Nation's telecommunications network is a uniquely complex and dynamic entity. It contains hundreds of millions of parts that work together to provide simultaneous end-to-end connection for its millions of users.

Its standards for performance, economy and flexibility are the envy of the world.

From its very beginning, the Bell System's goal has been universal service. That goal has been largely achieved as a result of organized creation and application of technology.

The Bell System's uniquely integrated structure has been essential to the steady stream of technological innovation that helped us achieve the universal service goal.

But technological innovation is not a past-tense affair. It is a continuing process that creates new services, systems and economies for customers.

Technology gives us the means to assure that we can hit the moving target—changing customer needs—in the best way possible.

I would like to examine for a moment the relationship between telecommunications innovation and integration. Other witnesses have discussed the relationship from their varying perspectives. I will try to explain it from a technological viewpoint.

The innovation process begins with identification of needs. Through constant interaction with the operating telephone companies and their customers, A.T. & T. determines preference and priorities for services. Through Bell Laboratories, A.T. & T. determines technical opportunities and the economic factors involved in meeting those needs.

Systems engineering at Bell Labs translates the needs identified by A.T. & T. and the operating telephone companies into system concepts for meeting these needs.

Systems engineers look to worldwide research—including, importantly, to Bell Labs scientists—for the new knowledge needed to carry out the concepts. Systems engineers also look to Bell Labs development engineers who are responsible for designing the specific products needed to meet the Bell System's requirements.

Development engineers, in turn, work directly with their Western Electric counterparts who have responsibility for manufacturing products.

Often this interface occurs directly at the Western Electric plant, where Bell Labs people prepare final designs for manufacture and Western Electric people prepare to manufacture products based on those designs.

The innovation process is complete only when the new equipment is installed and working. This is the responsibility of A.T. & T. long lines and each of the operating telephone companies, with continuous assistance from Western Electric and Bell Labs.

Thus, in concert, and under A.T. & T. guidance, the various Bell System units provide comprehensive plans for network change and introduction of new products and services.

Technological innovation in telecommunications depends on—in fact, thrives on—the Bell System's integrated structure.

The neat organizational lines I described are only one dimension of integration. In fact, the lines are constantly crossed and crisscrossed. Interaction among all Bell System units occurs constantly in order to plan and deliver new technology into the network.

There is a continuous and free exchange of every type of technical information among all Bell System partners.

Essential to this interaction is that each separate Bell System unit shares a common goal: service to customers.

Each recognizes the unique role of the others in achieving that goal. Each deals openly and fully with the others—without secrets, without concern for proprietary interests, without inflexible adherence to an initial set of specifications and designs.

We have those qualities in the Bell System today because of its integrated structure, and it is a tremendous plus.

Fully separated subsidiaries and arm's-length transactions in nearly all ways runs counter to this proposition.

Another central element in the innovation process is that Bell Laboratories has end-to-end—literally terminal-to-terminal—responsibility for technological innovation in the Bell System.

This end-to-end responsibility for network design gives us the flexibility to optimize the network as a whole, and the flexibility to introduce new technology today and in the future.

Importantly, in engineering and reengineering the network, we focus on total performance and overall costs, without concern for where in the network the costs fall.

Introduction of Touch-Tone dialing is an example. Because of our end-to-end responsibilities we were able to modify the telephone set to generate tones, and to modify switching equipment throughout the network to receive tones and, in anticipation of Touch-Tone service throughout the network, we were able to control the volume of the tones so that they would not interfere with other transmissions.

End-to-end responsibility also enables us to develop and apply common technologies. For example, the processors for switching systems—toll and local—have common requirements.

Outstanding among them is the need for very high reliability, far exceeding that needed in general-purpose computers. We have indeed developed a processor that serves both the No. 1A local and No. 4 toll electronic switching systems; it is designed for an average downtime of less than 2 hours in 40 years.

Development of common equipment permits us to hold down development costs. It also increases the volume of manufacture, which reduces manufacturing costs. And networkwide deployment also reduces training and maintenance costs.

There are many more examples of the advantage of the Bell System's structure and its end-to-end responsibilities.

But I will now turn to some brief illustrations of the technological innovations that this environment has fostered.

Introduction of direct distance dialing, beginning in 1951, illustrates the scope of the task of implementing change in the network and the value of centralized planning.

It required establishment of a nationwide numbering plan to give each main telephone a unique number.

It required modification of every switching system in the network. It required development of a new switching hierarchy and automatic alternate routing to find free network paths.

And it required the creation and implementation of transmission standards for all dialed-up connections.

Last week my colleague, Billy B. Oliver, spoke of the stored program control network. This entity requires that stored program equipment be deployed all across the network, and that electronic switching systems and operator data bases in the network be able to communicate with each other through a high-speed signaling system.

He noted the ability of this network to gather and distribute information useful to customers in the most flexible and imaginative ways.

To implement this concept requires modification of the control programs in all electronic switching systems in the Nation in a consistent, compatible, and timely fashion.

This is a task we can carry out because of our networkwide planning and engineering responsibilities, and it is going forward at this very moment.

Nor is presently available technology the end of opportunity. Continuing dramatic decreases in the cost and size of large-scale

integrated circuits are helping us to deploy logic and processing capabilities end-to-end in the network.

This will be a driving force for creation of new services based on ready access to the network intelligence.

Lightwave transmission systems are now planned for early introduction into the interexchange plant. In the future, these systems may find applications for local, transcontinental, and hopefully, intercontinental telecommunications.

Emerging digital systems will help us to broaden the range of data, facsimile, graphics, and other nonvoice services available through the network.

Looking farther ahead, automatic voice recognition and speech synthesis also appear to have great potential for providing new services.

To summarize, the Bell System has created the most technologically advanced network in the world. It has made this Nation the world leader in telecommunications technology.

Also, it has fostered the world's most innovative and productive private research and development laboratory.

I believe that Bell Laboratories' technological achievements are well-known to this committee.

For example, last year two Bell Labs scientists became our sixth and seventh Nobel laureates. Our achievements extend from such basic research to advances in solid-state electronics that are key to progress in telecommunications and other industries.

The Government has drawn upon Bell Laboratories and the Bell System when the national interest was at stake. There have been many Bell Laboratories' activities in support of the Government, including fire control radar, missile defense systems, satellite guidance systems, underwater sound systems, and special communications systems.

In these and in many other instances, the Nation looked to the Bell System because of its unique capabilities.

One example occurred in 1962, when James E. Webb, Administrator of the National Aeronautics and Space Administration, asked for Bell System assistance in the space program through the creation of Bellcomm, Inc., a company in which I eventually served as president.

Mr. Webb said:

The job of coordinating a worldwide communications network must have presented many of the same kinds of systems planning, engineering, and integration problems on a very large scale, that we expect to encounter in carrying out the nation's program of manned space exploration.

We continue to be ready to serve the Nation whenever it needs us.

As we look ahead, it is clear that improved telecommunications capabilities and services will continue to depend on a steady flow of technological innovation.

The technical integration that was essential to innovation in the past will be essential in the future.

Mr. Chairman, I believe this is a time when we need to strengthen the basic technological capabilities of the Nation's telecommunication system.

It is a time to reinforce the integration within the Bell System from which technology evolves and flows. And it is a time to support the vital interfaces among partners that will enable us to view the network as a single entity, to plan, engineer, build and operate it as a national resource that combines the benefits of unified responsibility with the flexibility to meet individual customers' needs.

But, Mr. Chairman, when I examine provisions of the legislation before the Senate, they seem to speak in opposite terms.

Phrases such as "fully separated," "arm's-length" and others contained in the proposed legislation speak to fractionalization of purpose and disunity of responsibility for planning and operation that will disrupt the technical integration of the telecommunications network, impede the flow of technological innovation, delay the evolution of the network and the new services available through it, and ultimately do a disservice to customers.

I have a number of comments on specific sections of S. 611 and S. 622 that are attached to my filed testimony. I would just like to summarize three major points.

First, the requirement in S. 611 that category II carriers be fully separated from any affiliated entity producing or providing telecommunications equipment amounts to fragmentation of the technical resources of the Bell System.

Instead of the open interfaces we now enjoy, the legislation would seem to require interactions among corporations with differing objectives and a multiplicity of trade secrets and proprietary interest barriers.

This separateness is the very antithesis of our integrated structure, and would only serve to delay the pace of technological innovation.

My second major concern is that under other sections of the legislation, Bell Laboratories would no longer have end-to-end responsibility for technological innovation in the network.

A requirement that separated carriers must operate at arm's-length would impair the technical integration that is essential to the continued vitality of innovation.

Finally, I wish to speak on a subject that I am personally concerned about—the future of Bell Laboratories.

Under the proposed legislation, there is uncertainty about the structure of Bell Laboratories and the support it needs for its programs.

The loss of Bell Labs' full potential and competence not only would delay innovation in the network, but would reduce the ability of the United States to maintain its worldwide leadership in telecommunications technology.

I ask that Bell Laboratories be able to continue to do what it does best—work as a partner in a technically integrated Bell System to innovate in the public interest.

In particular, I feel it is in the public's best interest that any legislation support, rather than hinder, integrated planning, with common objectives, for the entire network.

The legislation should not impair the capability to develop and apply new technology in the introduction of new telecommunications services for customers.

In addition, it should assure that telecommunications research and development can continue to be carried out centrally, in the way it is now done in Bell Labs. Cooperative technical interaction has provided the Nation's preeminence in the telecommunications network.

Specific congressional guidance to permit continuation of such technical planning will foster further technological innovation. That, in turn, will assure the people of this country that the future quality, reliability, and innovativeness of their telecommunications services will match the same high standards that have prevailed in the past.

Mr. Chairman, I believe that the Senate should explicitly assure that no artificial barriers are placed in the path of the technological leadership that has made this country's telecommunications the world standard for excellence.

Thank you.

[The statement follows:]

STATEMENT OF IAN M. ROSS ON BEHALF OF AMERICAN TELEPHONE & TELEGRAPH Co.

My name is Ian M. Ross. I am President of Bell Telephone Laboratories, Inc., with offices in Murray Hill, New Jersey.

I received my B.A. in Engineering from Cambridge University in 1948 and M.A. and Ph.D. degrees in Electrical Engineering from Cambridge University in 1952.

My Bell System career began with Bell Laboratories in 1952 as a Member of Technical Staff in the Research Division working on solid-state electronic devices. In subsequent years at Bell Laboratories, I had various assignments in research and development of semiconductor electronics.

In 1964, I was appointed Managing Director of Bellcomm, Inc., a Bell System subsidiary which provided systems engineering support for the Apollo manned space flight program. I became President of Bellcomm in 1968.

In 1971, I returned to Bell Laboratories as Executive Director of the Network Planning Division, became Vice President of Network Planning and Customer Services in 1973 and Executive Vice President, Systems Engineering and Development in 1976. I assumed my present position this year.

The purpose of my testimony today is to describe technical integration in Bell Laboratories and the Bell System and its benefits to the process of technological innovation, and to explain how the capability could be impaired by the legislation pending before the Senate.

In my view, certain sections of this legislation could disrupt the Bell System's technical integration and impede the flow of new technology into the telecommunications network. This could deprive the public of valuable new services and economies.

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But technological innovation is not a past-tense affair. It is a continuing process that creates new services, systems and economies for customers. Technology gives us the means to assure that we can hit the moving target—changing customer needs—in the best way possible.

I would like to examine for a moment the relationship between telecommunications innovation and integration. Other witnesses have discussed the relationship from their varying perspectives. I will try to explain it from a technological viewpoint.

The innovation process begins with identification of needs. Through constant interaction with the Operating Telephone Companies and their customers, AT&T determines preference and priorities for services. Through Bell Laboratories, AT&T

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Systems engineering at Bell Labs translates the needs identified by AT&T and the Operating Telephone Companies into system concepts for meeting these needs. Systems engineers look to worldwide research—including, importantly, to Bell Labs scientists—for the new knowledge needed to carry out the concepts. Systems engineers also look to Bell Labs development engineers who are responsible for designing the specific products needed to meet the Bell System's requirements. Development engineers, in turn, work directly with their Western Electric counterparts who have responsibility for manufacturing products. Often this interface occurs directly at the Western Electric plant, where Bell Labs people prepare final designs for manufacture and Western Electric people prepare to manufacture products based on those designs.

The innovation process is complete only when the new equipment is installed and working. This is the responsibility of AT&T Long Lines and each of the Operating Telephone Companies, with continuous assistance from Western Electric and Bell Labs. Thus, in concert, and under AT&T guidance, the various Bell System units provide comprehensive plans for network change and introduction of new products and services.

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Mr. Chairman, I believe this is a time when we need to strengthen the basic technological capabilities of the nation's telecommunication system. It is a time to reinforce the integration within the Bell System from which technology evolves and flows. And it is a time to support the vital interfaces among partners that will enable us to view the network as a single entity, to plan, engineer, build and operate it as a national resource that combines the benefits of unified responsibility with the flexibility to meet individual customers' needs.

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proprietary interest barriers. This separateness is the very antithesis of our integrated structure, and would only serve to delay the pace of technological innovation.

My second major concern is that under other Sections of the legislation, Bell Laboratories would no longer have end-to-end responsibility for technological innovation in the network. A requirement that separated carriers must operate at arms length would impair the technical integration that is essential to the continued vitality of innovation. It substitutes for our end-to-end perspective on the network an artificial, piecemeal view. This would occur at the very time when new technology is steadily blurring the divisions among the parts of the network, and when customers are increasingly looking to the network to provide a wealth of new services.

Finally, I wish to speak on a subject that I am personally concerned about—the future of Bell Laboratories. Under the proposed legislation there is uncertainty about the structure of Bell Laboratories and the support it needs for its programs. Bell Laboratories has innovated in every facet of telecommunications. Although scientists and engineers from the entire world have contributed to communications technology, the preponderance of new ideas—especially new systems—has originated at Bell Laboratories. The result is a telecommunications system that is the envy of every other telephone administration in the world, and a telecommunications research and development laboratory that is truly a national resource. The loss of Bell Labs full potential and competence not only would delay innovation in the network, but would reduce the ability of the U.S. to maintain its worldwide leadership in telecommunications technology.

I ask that Bell Laboratories be able to continue to do what it does best—work as a partner in a technically integrated Bell System to innovate in the public interest. In particular, I feel it is in the public's best interest that any legislation support, rather than hinder, integrated planning, with common objectives, for the entire network. The legislation should not impair the capability to develop and apply new technology in the introduction of new telecommunications services for customers. In addition, it should assure that telecommunications research and development can continue to be carried out centrally, in the way it is now done in Bell Labs. Cooperative technical interaction has provided the nation's preeminence in the telecommunications network. Specific Congressional guidance to permit continuation of such technical planning will foster further technological innovation. That, in turn, will assure the people of this country that the future quality, reliability and innovativeness of their telecommunications services will match the same high standards that have prevailed in the past.

Mr. Chairman, I believe that the Senate should explicitly assure that no artificial barriers are placed in the path of the technological leadership that has made this country's telecommunications the world standard for excellence.

Thank you.

ATTACHMENT A

S. 611 essentially authorizes or mandates a kind of separateness between the Operating Telephone Companies and Western Electric that is the very antithesis of the Bell System's integrated structure.

For example, amended Section 203(b) in S. 611 provides that any "Category II carrier"—plainly the Operating Telephone Companies and presumably Long Lines—"shall be fully separated from an affiliated entity which produces or provides any telecommunications equipment." The effect of this Section, as worded, is fragmentation of the technical resources of the Bell System.

Amended Section 203(g) of S. 611 would limit the Bell System's ability to integrate services. A key element in making efficient use of the network and its technological potential is, in fact, sharing facilities for multiple service offerings.

As we understand amended Section 205(d) of S. 611, the current exchange service of Bell System Operating Telephone Companies, and the current intercity service of A.T. & T.'s Long Lines Department, must be offered by fully separated carriers. And as we understand amended Section 214(e) of S. 611, any joint technical planning between these carriers would be carried out under FCC auspices, presumably in conjunction with competitive carriers. It also appears that amended Section 225(d)(2)(H) of S. 622 would have the same requirement regarding joint planning under FCC auspices. For joint planning to succeed, common objectives must be shared among all partners. Under this proposal, joint planning would be difficult, costly and inefficient because all carriers would not share common objectives. Without integration many new services simply won't work. There is also the matter of incentive in separated entities; it is not clear that either an exchange or interexchange carrier, alone, would be motivated to introduce certain new services.

It would appear that Section 207(b) of S. 611 would give the FCC authority to impose technical standards in the event of a lack of agreement among carriers. We doubt that any government agency is equipped for such a responsibility. Our experience shows that the creation of economical, service-improving technical standards for a system as complex as the nation's telecommunications network is a massive undertaking. Literally hundreds of Bell Laboratories engineers with the highest academic qualifications and vast experience are involved in just this effort. We question whether Congress is prepared to authorize the FCC to develop the internal expertise required to analyze such problems adequately. The alternative—an FCC-sponsored attempt to arrive at agreements among parties with diverse interests—can only lead to protracted delay in publicly beneficial innovation.

Senator HOLLINGS. Very good. Who is next?

Mr. OLSON. John Preston, associate general counsel.

Mr. PRESTON. Mr. Chairman, Senators, these bills we are considering this afternoon would accomplish a very fundamental shift in congressional policy. I don't enter an objection to that reorientation of policy, but I would like to emphasize that a shift from an environment of regulated monopoly achieved pursuant to congressionally mandated policy over more than half a century, to a new environment combining regulation of traditional services with open entry for new services, plus unregulated competition from alternative or substitutable services, will disrupt traditional legal, economic, and behavioral concepts. For regulators, carriers, competitors, and courts to implement the policy changes as Congress intends by this legislation, will require very clear statements by Congress of the new policy, its goals and objectives, of the intended relationships between regulated and unregulated providers of service, between the application of traditional regulatory public interest concepts and obligations and the quite different standards arising from the antitrust and other laws relating to general business activity.

The industry, the new entrants, the regulators and the courts must be given clear policy directives.

I would like to identify some of the major areas where I believe the intent of Congress should be more precise and more explicit. I am prepared to provide to the staff, if it wishes, suggested legislative language.

One of the stated goals of this legislation is that of preserving basic services, universally available at just and reasonable rates. Other witnesses have already described how basic service delivered to the public by means of the core network, how it is planned, engineered and managed, what services it can provide now and in the foreseeable future, how the exchange network relates to and is a part of the core network.

The conclusions drawn from this testimony are several. First, the network—interexchange and intraexchange—although provided by some 1,600 entities, must be designed and managed as a single integrated network. The bills accord some recognition to the network as an essential national resource and to the need for coordination of planning, construction and management, but the legislative needs greater precision.

Up to now, such industry coordination has been possible by partners providing noncompetitive services.

Second, the legislation distinguishes between interexchange and intraexchange services and requires each to be provided through fully separated entities without any common management or own-

ership of facilities. Other witnesses have described how some exchange services are provided over interexchange facilities and how interexchange services utilize intraexchange facilities. Switching and transmission facilities used for both exchange and interexchange services are often jointly owned by the carriers that jointly provide the service. Requiring massive shifts of ownership of facilities would be highly disruptive to the industry and to its millions of investors who own the facilities, often by means of mortgage bonds or under indentures with restrictions on property transfers. The prohibition of joint ownership of facilities used to provide a "joint through" service is inconsistent with the way telephone service is provided, serves no purpose and would be highly disruptive.

The goal of greater consumer choice. If the stated goal of greater consumer choice in all telecommunications and related markets is to be achieved, it follows that all suppliers who have a product or service which satisfies a market demand should be permitted to compete on equal terms. A system which imposes arbitrary handicaps on some suppliers but not on others, is not competition: it is government allocation and will not deliver to consumers the intended benefit from competition.

The imposition on Bell System affiliates offering competitive services of restrictions on their ability to enter and serve competitive, unregulated markets on equal terms with their competitors will deny to consumers the full benefits of competition. The legislation would invite and encourage the entry of such competitors, who have already signaled their interest, as IBM, Xerox, ITT, and Exxon. All of them have significant research, development and manufacturing capability, which they, and others still in the wings, would be entirely free to bring to bear on the markets they intend to serve.

In short, they can be expected to bring to their market penetration the full benefits of their vertical and horizontal integration, and rightly so. But bringing to consumers the full benefits of fair competition demands that Bell be similarly free to offer products and services in competitive markets through affiliates having access to research, development, and manufacturing facilities.

To accomplish these goals, several refinements in the legislation are needed. First, the definition of a fully separated entity and the related section 212 concerning qualification of directors, need amendment to focus on marketplace controls, rather than internal operations.

Second, the 1956 final judgment, which restricted the Bell System to regulated common carrier activities, is clearly not appropriate to the new environment. Both Senate bills recognize this, and both would partially override the final judgment. Both provisions, however, are in need of amendment to more precisely accomplish their intended purpose.

The goal of restructuring the industry. We most strongly urge that section 227 of S. 611 be deleted. It asserts that nothing in this act shall be construed as a sense of Congress with regard to any pending litigation. However, the thrust of the entire act is to recast the structure of the industry into the mold the Congress now sees as appropriate to serve the needs of society.

To invite the courts to perform further radical surgery, as each may see fit, as section 227 now does, would permit the courts, on a piecemeal basis, to destroy the industry structure Congress will have so painfully erected.

We do not seek to have the Congress legislatively moot that part of the Government antitrust suit which alleges anticompetitive conduct. But Congress should make it clear that by this legislation, it has mandated the industry structure which it deems appropriate for the future, and that it reserves to itself the right to legislate any further changes thought to be in the public interest.

The balance between public regulation and marketplace regulation will have been struck by the Congress.

In addition, the legislation needs to be explicit that the industry is not to be penalized for the consequences of a structure mandated by the Congress in the past and the market shares that derive from it, or for the new structure mandated by the new legislative approach to the supply of telecommunications and related equipment and services.

In addition to the provisions already discussed, there are other provisions the legal consequences of which seem to be counterproductive or internally inconsistent.

One such provision is amended section 205 in S. 611, which would give the Commission expansive powers to prescribe conditions on category II carriers and their affiliates, including the power effectively to require divestiture of affiliates.

This should be compared with section 225 of S. 622 which gives the FCC correspondingly broad regulatory powers but explicitly denies the power to order divestiture.

If the Congress wishes a marketplace test of the restructuring accomplished by this act, it might amend present section 215 to require a report and recommendation from the Commission to Congress, but Congress should not permit the Commission by rule, to undo the work of Congress.

There also appears to be a conflict between amended sections 204(b) and section 204(h)(3) of S. 611. The first would prevent any carrier affiliated with a category II carrier from being designated as category I. The second provision would permit a fully separated carrier which provides only services subject to effective competition, to apply for designation as category I, but would leave the grant of the application to Commission discretion consistent with the policies of the act. Both sections should provide for the classification as category I of any carrier providing only services subject to effective competition, with Commission discretion limited to that factual determination.

I would also urge that amended section 204 be written to substitute an economic definition of "effective competition" for the arbitrary market share definition in the bill. The definition proposed to you by Henry Geller is one we could support.

Another provision of S. 611 deletes the provision of existing law which permits concession service to employees, directors and pensioners. Such concession service has long been an important part of the benefit package for employment in this industry, similar to benefits available to airline, railroad and steamship employees and many others throughout industry. Its elimination would doubtless

result, after collective bargaining, in corresponding wage and salary adjustments which, considering the incremental cost of providing such service, would cost the ratepayer more.

Still another change made by S. 611 is deletion of the provision in existing law that makes acquisitions and mergers of carriers, when approved by the Commission, immune from antitrust attack. The bill requires the creation of new subsidiaries and realignment of facility ownerships and service offerings.

As conditions settle down in the industry following the massive restructuring required by the act, it may well be that certain acquisitions and mergers then will be required for efficient service of the public interest.

It seems unwise policy to deny to the Commission, which will be presiding over the evolution of the industry in the new environment, the power to make public interest determinations in such matters which will have binding effect and free the industry from further vexatious litigation.

Perhaps the most extreme provision in the entire bill is section 230. That section is a broad grant of power to the Commission to order divestiture of facilities and to prohibit and control ownership of facilities and other media interests, however it may please the Commission to promote the policy of the act. I am not aware of any other grant of power by Congress as broad as this which has survived the constitutional test. Whether constitutional or not, this section, granting to an arm of Government the absolute and unqualified power to limit the number of facilities any carrier could own, is an assertion of governmental control by political fiat which is at war with the principles of a free and democratic society.

These are the broad areas of the present bills which give us the greatest concern, and I commend them to your further consideration. We shall be glad to work with your staff in developing appropriate language to express your intent.

With such changes, we believe legislation can be enacted to accomplish the stated goals and objectives, and we offer our continuing cooperation to that end.

Thank you.

[The statement follows:]

STATEMENT OF JOHN F. PRESTON ON BEHALF OF AMERICAN TELEPHONE & TELEGRAPH CO.

LEGAL ASPECTS OF CERTAIN DOMESTIC COMMON CARRIER PROVISIONS IN S. 611 AND S. 622

This paper will comment on the legal implications of certain of the provisions applying to Domestic Common Carriers appearing in the current version of Senate Bills S. 611 and S. 622. It covers only major points and is not intended to be inclusive of all our concerns, nor does it cover administrative procedure, broadcast or international sections of the Bills.

My name is John Preston. I am Associate General Counsel of AT&T. Prior positions in the Bell System include General Solicitor and General Attorney of AT&T, Vice President and General Counsel of Ohio Bell and General Attorney of C & P. Before entering the Bell System 27 years ago, my legal career included service as Trial Counsel to the NLRB and Counsel to the Senate-House Joint Committee on Labor-Management Relations, and Special Agent of the FBI.

I. The need for a clear and definitive statement of policy, goals, and objectives

The proposed legislation will accomplish a significant and far-reaching alteration in the way telecommunications and related services are delivered to the American public. The stated purposes are to assure continued availability and viability of basic and essential services, subject to continued public accountability of the provid-

ers of such services by means of pervasive regulation, while contemporaneously creating conditions conducive to the entry of competitive suppliers who will give customers alternative choices in most markets.

This is a very fundamental shift in congressional policy. I do not enter an objection to that shift. But I do emphasize that a shift from an environment of regulated monopoly achieved pursuant to congressionally mandated policy over more than half a century to a new environment combining regulation of traditional services with open entry for new services plus unregulated competition from alternative or substitutable services will disrupt traditional legal, economic and behavioral concepts. For regulators, carriers, competitors and courts to implement the policy changes as Congress intends by this legislation, will require very clear statements by Congress of the new policy, its goals and objectives, of the intended relationships between regulated and unregulated providers of service, between the application of traditional regulatory public interest concepts and obligations and the quite different standards arising from the antitrust and other laws relating to general business activity.

Without such clear statement of policy and objectives, including a careful balancing of the standards to which business conduct is expected to adhere and be judged, between public interest criteria of regulation where effective competition is absent and the pro-competition standard of the unregulated market place, the intent of Congress will be frustrated. The industry, the new entrants, the regulators and the courts must be given clear policy directives.

In the paragraphs that follow, I will identify some of the major areas where I believe the intent of Congress could be more precise and explicit. I am prepared to provide to the staff, if it wishes, suggested legislative language.

II. The goal of preserving basic services, universally available, at just and reasonable rates

I believe there is no dissent from the assertion that this country now has the best, the most widely available and the lowest cost service anywhere in the world. The intent of the legislation is to open tele-communications markets to wider consumer choice without impairment of the existing basic service or the system that has made it possible.

Other witnesses have described the core network—how it is planned, engineered and managed, what services it can provide now and in the foreseeable future, how the exchange network relates to and is a part of the core network. The conclusions to be drawn from this are several:

First, the network (interexchange and intraexchange), although provided by some 1600 entities, must be designed and managed as a single integrated network. The Bills accord some recognition to the network as an essential national resource and to the need for coordination of planning, construction and management, but the legislation needs greater precision.

Second, the legislation distinguishes between interexchange and intraexchange services and requires each to be provided through fully separated entities without any common management or ownership of facilities. Other witnesses have described how some exchange services are provided over interexchange facilities and how interexchange services utilize intraexchange facilities. Switching and transmission facilities used for both exchange and interexchange services are often jointly owned by the carriers that jointly provide the service. Requiring massive shifts of ownership of facilities would be highly disruptive to the industry and to its millions of investors who own the facilities, often by means of mortgage bonds or indentures with restrictions on property transfers. The prohibition of joint ownership of facilities used to provide a "joint through" service is inconsistent with the way telephone service is provided, serves no purpose and would be highly disruptive.

Another aspect of this problem that needs to be addressed concerns the economic viability of the intraexchange carriers. The legislation would strip from them, at least as regulated entities, revenues from both terminal equipment and intercity services. As industry cost studies show, the remaining local exchange service would, in many cases, simply not be economically viable without massive local rate increases. The access charge and exchange maintenance plan are designed to partially alleviate this problem. Another witness has discussed the impact on local rates of these provisions. I suggest that permitting the exchange carrier to maintain an ownership interest in interconnected interexchange facilities would provide a revenue flow that would be a benefit to local exchange subscribers.

III. The goal of greater consumer choice

If the stated goal of greater consumer choice in all telecommunications and related markets is to be achieved, it follows that all suppliers who have a product or service which satisfies a market demand should be permitted to compete on equal

terms. A system which imposes arbitrary handicaps on some suppliers but not on others is not competition: it is government allocation.

We recognize that some services supplied by the Bell system which are deemed to be essential to the public need must continue to be regulated at least until effective competition can develop. The fact of regulation is itself a handicap for the Bell System, the necessity for which we accept. What we cannot accept, not only because it would be unfair to our investors but more importantly because it would restrict and frustrate consumer choice, is the imposition on Bell System affiliates offering competitive services of restrictions on their ability to enter and serve competitive unregulated markets on equal terms.

The legislation would invite and encourage the entry of such competitors, who have already signalled their interest, as IBM, Xerox, ITT and Exxon. All of them have significant research, development and manufacturing capability, which they, and others still in the wings, would be entirely free to bring to bear on the markets they intend to serve. In short, they can be expected to bring to their market penetration the full benefits of their vertical and horizontal integration, and rightly so. But bringing to consumers the full benefits of fair competition demands that Bell be similarly free to offer products and services in competitive markets through affiliates having access to research, development, and manufacturing facilities.

To accomplish these goals, several refinements in the legislation are needed. First, the definition of a fully separated entity and the related Sec. 212 concerning qualification of Directors, need amendment to focus on market place controls rather than internal operations.

There has been much discussion on this record of the need for full separation of subsidiaries or for a cost accounting structure. Such requirements appear to be designed to address three concerns. First, the need to remove any incentive to subsidize competitive activities with revenues from services not subject to effective competition. Second, to make available to competitors facilities at reasonable rates for use by them. And third, to assure that competing intercity networks will have access to exchange facilities, and thence to their customers, on reasonable terms.

I suggest to you that these objectives can be attained with simple and direct legislative requirements that will not destroy the benefits of the integrated structure which have given us today's quality of service, and without depending upon the availability of accounting safeguards.

By requiring a Bell Company to provide telecommunications facilities to all of its competitors at reasonable rates, and by permitting competitors the freedom to resell such facilities or to use them in providing their own services, it is possible to reduce the incentive for cross-subsidies or predatory pricing. Thus, the first two of your concerns can be met. The third is covered by proposed Sec. 207. However, I would strongly endorse the amendments to Sec. 207 proposed by Henry Geller.

Second, the 1956 Final Judgment, which restricted the Bell System to regulated common carrier activities, is clearly not appropriate to the new environment. Both Senate Bills recognize this, and both would partially override the Final Judgment. Both provisions, however, are in need of amendment to more precisely accomplish their intended purpose.

IV. The goal of restructuring the industry

In addition, we most strongly urge that Section 227 of S. 611 be deleted. It asserts that nothing in this Act shall be construed as a sense of Congress with regard to any pending litigation. However, the thrust of the entire Act is to recast the structure of the industry into the mold the Congress now sees as appropriate to serve the needs of society. To invite the courts to perform further radical surgery, as Section 227 now does, would permit the courts, on a piecemeal basis, to destroy the industry structure Congress will have so painfully erected. We do not seek to have the Congress legislatively moot that part of the government antitrust suit which alleges anti-competitive conduct. But Congress should make it clear that by this legislation it has mandated the industry structure which it deems appropriate for the future and that it reserves to itself the right to legislate any further changes thought to be in the public interest. The balance between public regulation and market place regulation will have been struck by the Congress. In addition, the legislation needs to be explicit that the industry is not to be penalized for the consequence of a structure mandated by the Congress in the past and the market shares that derive it, or for the new structure mandated by the new legislative approach to the supply of telecommunications and related equipment and services.

V. Specific provisions

In addition to the provisions already discussed, there are other provisions the legal consequences of which seem to be counter-productive or intentionally inconsistent.

One such provision is amended Section 205 (page 30) which would give the Commission expansive powers to prescribe conditions on Category II carriers and their affiliates, including the power effectively to require divestiture of affiliates. This should be compared with Section 225 of S. 622 which gives the FCC correspondingly broad regulatory powers but explicitly denies the power to order divestiture. If the Congress wishes a market place test of the restructuring accomplished by this Act, it would amend present Section 215 to require a report and recommendation from the Commission to Congress, but Congress should not permit the Commission, by rule, to undo the work of Congress.

There appears to be a conflict between amended Section 204(b) (page 26) and Section 204(h)(3) (page 29). The first would prevent any carrier affiliated with a Category II carrier from being designated as Category I. The second provision referred to would permit a fully separated carrier which provides only services subject to effective competition to apply for designation as Category I, but would leave the grant of the application to Commission discretion consistent with the policies of the Act. Both sections could provide for the classification as Category I of any carrier providing only services subject to effective competition, with Commission discretion limited to that factual determination.

I would also urge that amended Section 204(e) (page 27) be written to substitute an economic definition of "effective competition" for the arbitrary market share definition in the Bill. The definition proposed to you by Henry Geller is one we could support.

The Bill (S. 611) at page 38 deletes the provision of existing law which permits concession service to employees, directors and pensioners. Such concession service has long been an important part of the benefit package for employment in this industry, similar to benefits available to airline, railroad and steamship employees and many others throughout industry. Its elimination would doubtless result, after collective bargaining, in corresponding wage and salary adjustments which, considering the incremental cost of providing such service, would cost the ratepayer more.

Still another change made by this Bill (S. 611) on page 52 is deletion of the provision in existing law that makes acquisitions and mergers of carriers, when approved by the Commission, immune from antitrust attack. The Bill requires the creation of new subsidiaries and realignment of facility ownerships and service offerings. As conditions settle down in the industry following the massive restructuring required by the Act, it may well be that certain acquisitions and mergers will be required for efficient service of the public interest. It seems unwise policy to deny to the Commission which will be presiding over the evolution of the industry in the new environment, the power to make public interest determinations in such matters which will have binding effect and free the industry from further vexatious litigation.

Perhaps the most extreme provision in the entire Bill in Section 230 on page 59. That Section is a broad grant of power to the Commission to order divestiture of facilities and to prohibit and control ownership of facilities and other media interests, however it may please the Commission to promote the policy of the Act. I am not aware of any other grant of power by Congress as broad as this which has survived the Constitutional test. Whether Constitutional or not, this section—granting to an arm of government the absolute and unqualified power to limit the number of facilities any carrier own—is an assertion of governmental control by political fiat which is at war with the principles of a free and democratic society.

These are the broad areas of the present Bills which give us the greatest concern and I commend them to your further consideration. We shall be glad to work with your staff in developing appropriate language to express your intent.

With such changes, we believe legislation can be enacted to accomplish the stated goals and objectives, and we offer our continuing cooperation to that end.

Senator HOLLINGS. Thank you.

Mr. OLSON. Why don't we have Mr. Goldstein on accounting, Mr. Chairman?

Senator HOLLINGS. Very good. We will be glad to hear from Mr. Goldstein.

Mr. GOLDSTEIN. Mr. Chairman, Senators, thank you for allowing me to appear again before you.

Senator Goldwater, I answered a question of yours this morning about the bonded indebtedness of the Bell System.

I think I overdid it a little bit. The actual number, rather than \$50 billion, is somewhat closer to \$40 billion, rather than \$50 billion.

I think the conclusions were essentially the same.

Senator GOLDWATER. More or less.

Mr. GOLDSTEIN. I would like to supplement the testimony I gave this morning and tell you about the status of the accounting system. I mentioned this morning that we do have an accounting system that is doing a very fine job of financial reporting. I also said what we don't have is a good cost accounting system that will allow us to determine accurately and routinely on an ongoing basis the cost of the individual services we provide our customers. The reason our accounting system doesn't do that cost accounting job is that it was never designed to do it.

We, as well as all other telephone companies, keep our books in accordance with the Uniform System of Accounts, because we are required to do it by the Communications Act of 1934.

Incidentally, that act provides once the Commission prescribed the Uniform System of Accounts, telephone companies are not permitted to keep any other system of accounts, unless specifically authorized by the Commission.

Back in 1934, when this provision was passed, telephone companies offered essentially two kinds of service, local and long distance. Telephone company services were then unequivocally regulated monopolies. Regulators of telephone companies were basically interested only in overall financial performance, total rate of return, earnings per share, and so on.

For internal management purposes, we kept completely different sets of indices and measures that allowed us to manage our business internally, but we didn't look toward the cost of individual services.

The reason was they were of relatively minor interest.

This changed with the advent of competition. As competition came into being, we had to have more special cost studies to determine the costs of these services as Federal and State commissions alike asked for these.

Often they did so under pressure of new competitors who increasingly intervened in the various rate cases. Cost studies do obtain good information, we believe reasonably good information that do get at the costs of service.

I don't want to leave the impression we are just flying blind. What we don't have is a system that can do this on an ongoing routine basis.

Cost studies are easy to attack. In particular, they're easy to attack by those who are interested in having our prices change one way or the other.

There were really two major areas of attack on some of those studies.

First, it was charged the numbers were inaccurate. To be sure, it's the nature of statistical studies that you don't get 100-percent precision and accuracy. We believe for the purposes that they were intended, these numbers were accurate enough.

The second area was that the methodology of using the numbers to arrive at the cost was incorrect.

I got into that this morning. I would say it was this area of methodology rather than the precision of the numbers themselves that caused most of the controversy.

Not the numbers so much, but the methodology.

In the early 1970's about the time this was all happening, we were also becoming aware that we needed better information about the cost of individual services for internal management purposes. We were beginning to see that indices and other productivity measures we were using needed to be supplemented by specific information, cost information, on a routine basis for individual services.

So it came about that in 1973 the Bell System undertook to develop a cost accounting system, not just costs but also revenues. We called it functional accounting.

This system was based on the most modern data processing capabilities and would give us routinely on an ongoing basis the costs and revenue data our managers would need to run the business, as well as the data we needed to satisfy the regulatory needs of this new multiservice competitive environment.

Let me tell you where we stand on the development of this.

I mentioned this morning we spent something like \$400 million on this, mostly to bring the various feeder systems up to snuff.

We have completed the development of what we call stages 1 and 2 of functional accounting. These stages of functional accounting will have been introduced into all our telephone companies by the end of next year, by the end of 1980.

What do stages 1 and 2 do? Two things. First, they introduce the procedures and codes which are the foundation for the entire system.

Second, they provide us with pretty good accounting data to determine revenues and costs for the terminal equipment part of our business.

In other words, for that part of our business that is on the customer's premises.

By the end of next year or a little later, we will have a cost accounting system that won't be perfect, but will give us the means to keep track of most of the transactions that relate to terminal equipment.

That is a pretty big step forward for us, since as you know, the area of terminal equipment cost has been fairly controversial.

Compared to the cost accounting for the network services, the theory and methodology related to cost accounting for terminal equipment is relatively straightforward.

The reason for that is that the hardware we use to provide terminal equipment services to any given customer is easily defined. It's a telephone or data set or PBX and serves a single customer, and that means this allocation problem I talked about this morning is not really very severe.

Therefore, I would say that the accounting problem with respect to terminal equipment is well on its way to solution.

On the other hand, accounting for network services is much more difficult.

The nationwide facilities network serves many different services; depending on how you count them, you can identify anywhere from 15 to 100 of different services that are provided over the network.

The problem is how to allocate the costs of the highly integrated network to these services.

Before you can allocate these you have to know what they are.

That is the job for functional accounting stage three. Stages 1 and 2 have to do with terminal equipment. Stage 3 has to do with network services.

Before I can tell you where we are in functional accounting stage 3, I have to go back to the revision of the uniform system of accounts that I mentioned this morning.

In a nutshell, as I said, what is happening is that we are waiting for an order from the FCC telling us what kind of system they want for the uniform code of accounting.

Until we get their order it's a bit hard to tell exactly how the proposed rewrite of the uniform system of accounts will affect the functional project.

What else will we have to do for functional accounting as a result of the uniform system of accounts rewrite? We don't know what the FCC will do about comments that we have given them and we don't know when we will receive this order. We are hopeful from what Chairman Ferris said we will get some preliminary information this summer.

With respect to the overall concept of functional accounting, we are in pretty good shape. We don't think the uniform system of accounts will change that very much.

That is what I am hopeful of at least. We think the rewrite of the USOA will have relatively less effect on stages 1 and 2. We looked at their proposal and compared it with what we have done, and we think that the changes that we will have to make to stage 1 and 2 will be manageable.

Now there is a problem that we can't really predict right now.

If terminal equipment is to be deregulated, as it appears likely by this legislation, we will have to make some changes because the deregulated business would probably have to be governed by different accounting rules than a regulated business.

The only other issue that concerns us here would be the effect of any changes in the structure of the Bell System that might come about as a result of these bills.

By that I mean the creation of additional subsidiaries which, as your questions indicated this morning, would require separate accounting systems rather than the single Uniform System of Accounts.

Now what are some of the implications of what I have told you?

First, you recognize the most difficult of these accounting problems is allocation of plant that is jointly used by two or more services.

The obvious way to solve that—also the wrong way—would be not to use the plant jointly. But there are good reasons for joint use of the plant. The reason is because it is an economical way of providing service. The result is lower prices for all the services so furnished to the public.

The Bell System network is a prime example of jointly used plant and the efficiencies and economies of today's telecommunications services are to a large measure due to their joint use. People suggested separate subsidiaries as a way of preventing cross-subsidi-

dization. Unfortunately, that does not solve the problem of the joint use of the plant I have been discussing.

Unless each of the subsidiaries owned all of the facilities that it needed to provide service in this approach, it would forego the economic advantages of joint use.

You still have the problem of allocating to each subsidiary the cost of the jointly used plant and that requires an accounting system.

We need an accounting system whether we have subsidiaries or not.

What I am saying is that a subsidiary is not a substitute for an accounting system.

An accounting system may be a substitute for a separate subsidiary for the purpose of preventing cross-subsidization, but the reverse is generally not true.

Mr. Chairman, we do have an accounting problem today.

We need to solve that problem.

In order to solve the problem we need a new system for obtaining the numbers and clear direction as to the method to be employed for using these numbers to obtain costs of service.

We are working on obtaining such a system, and so is the FCC.

What I am hoping, however, is that the problem is recognized for what it is and not solved in ways which will throw the baby out with the bath water.

I don't believe this legislation should require disaggregation of the facilities used for different services.

As I read the legislation, it does not.

I believe the legislation shouldn't mandate unnecessary separate subsidiaries just to solve the cross-subsidization problem.

It won't even do that when you have jointly used plant.

Now, having said all this, I have to say we have a transition problem. In other words, what do we do until we implement this new accounting system we have been talking about after the FCC prescribes it?

There are a number of approaches we can and should take. The first involves interim so-called cost of service record systems similar to the system we are developing in agreement with the FCC.

These systems rely heavily on manual and ad hoc procedures and tend to be somewhat cumbersome and expensive.

We don't like to proliferate them. However, we would not preclude creation of additional such systems for new competitive services, if necessary.

The second approach goes back to the point I was making about the status of stages 1 and 2, functional accounting.

I would proceed and suggest we proceed with creation of this accounting system and its application to terminal equipment which would take that out of the problem area.

The third approach I would suggest goes to the fundamental problem we have been discussing.

After all, accounting systems are a means to an end. They are not an end in themselves. What is fundamentally at issue, it seems to me, is to assure the public of competitors and regulators that competitive services are priced so they are not subsidized by non-competitive services.

In the intercity services arena, this involves a relatively small number of important controversial tariffs. In a somewhat analogous situation, there were some very troublesome rate and cost issues involved in ENFIA.

They were addressed and resolved after everyone pitched in with an objective of obtaining what was then called rough justice.

I am sure nobody who participated in that process felt it had the precision and polish we would have preferred.

Nevertheless, agreement was reached. I would suggest we approach the interim accounting problem and interim rate problem—in other words what to do until the uniform system of accounts has been revised and implemented—in that same spirit of rough justice.

We are prepared to work with the FCC staff and with interested parties to dispose of the most troublesome issues that now beset this ratemaking process.

Resolution of the issues will be necessary, in any event, as part of the USOA rewrite.

Many of the issues we have been discussing are not really accounting issues as such. Perhaps the most important one goes to the costing methodology which has a lot more to do with policy and philosophy than it has to do with account.

Furthermore, let me suggest that we are open to other ideas for resolving these matters expeditiously for this interim period with at least rough justice to all.

Let me suggest it would be very helpful to the process if the Congress would give guidance in the area of costing philosophy.

We, along with what I believe is the great majority of economists, think long-run incremental analysis is the appropriate way to determine prices.

FCC believes otherwise, and insisted on a fully distributed cost approach.

I know the House bill, H.R. 3333 contains a directive to the Commission to adopt what the bill calls long-run marginal costing concepts as a basis for pricing.

We commend that provision to your attention and would like to see a similar provision adopted by your committee.

While I am not the expert on this matter, we can certainly furnish additional material to you and your staff on this.

In my filed remarks, I discuss several matters relating to Bell Laboratory and Western Electric costs and how these are accounted for. Bell Labs and Western have excellent cost accounting systems, entirely suited to their purpose.

The cost of developing Western products is paid for by Western.

It's not paid for by the license contract. There have been allegations to the contrary, but my filed testimony rebuts those allegations fully.

These development costs are part of the price that the telephone companies pay for Western products.

They recover these costs by the rates they charge their customers.

Research and systems engineering work at Bell Labs is paid for by license contract money.

My filed testimony shows this cost is charged to the ultimate customer on an entirely fair basis.

In conclusion, let me sum up.

First: We agree that competitive services should not be cross-subsidized by noncompetitive services.

No question about that.

Second: We know that we need better cost accounting systems and we have been working diligently for a number of years and spent hundreds of millions of dollars toward that end.

We don't object to the establishment of subsidiaries where they make economic and management sense but it must be possible for these subsidiaries to be managed and operated with other affiliates within the horizontally and vertically integrated Bell System structure.

We know that there exists a problem with respect to how we would work in the interim until an accounting system is finally established. I gave you some suggestions relating to interim cost of service record systems, functional accounting for terminal equipment and an approach to achieve rough justice.

I indicated our willingness to consider with an open mind other approaches. I have tried to sketch for you the situation with respect to Western Electric and Bell Labs' accounting steps in order to suggest these don't pose any very large problem.

Let me conclude by thanking the committee for the opportunity to discuss this material before you. I would be surprised if I left you without any unanswered questions and I would be very happy to try to answer them.

Senator HOLLINGS. Thank you. I will be glad to yield to my colleagues for questions.

I must make a comment respectfully, of course. The panel must have been coached by a football coach before they came this afternoon if we are being subjected to rough justice, hit high and hit low. And all around. Now, Mr. Goldstein, you say we agree that competitive services should not be cross-subsidized by noncompetitive services. That is all we are trying to do. We have to take the facts as they exist. Not as we wish them to be.

As they now exist, you have the monopoly common carrier, Bell System, working extremely well. You also had by court decision access mandated to that local exchange by decisions coming down the line so as you try to characterize what is competitive and what is noncompetitive, you can see at the very onset that you are going to have to separate MTS from the local exchange and all types of MTS services.

It's said that would be disastrous. The question is whether it can be. For example, Mr. Tanenbaum says Bell Canada is not owned by A.T. & T., but this morning we heard there is in Canada a completely separate company which operates all the long-distance communications and Bell uses the Canadian network in its integrated alternate route switching of long-distance U.S. traffic.

How does that square with the assertion you can't operate with a network of separate subsidiaries? That goes through our mind.

That is the only change that we really make to the structure. What we are trying in responding to exactly what you say we agree should be done, and that is competitive services not be cross-

subsidized, then we characterize them in the bill and can embellish upon them, fine-tune them and otherwise, but having to use that approach, it's up to Bell to make that decision to come into the competitive world.

We don't force them into doing anything. Certainly no one will get into their common carrier field and local exchange and basic service and what have you. So I know as a lawyer, for example, I have written briefs before myself and you can safely examine Mr. Preston on one page where we have the FCC make the finding and the other one says don't take that power away from Congress.

When we look at the requirements, for example, and I don't know if we will mandate and settle all antitrust cases with the information we have.

You say we ought to fix it and once it's fixed, Congress should not permit the Commission by rule to undo the work of the Congress.

Two pages later, it seems unwise policy to deny to the Commission which will be presiding over the evolution of the industry the power to make public interest determinations in such matters which will have binding effect and free the industry from further vexatious litigation.

So you get both ways and you come into a section by listing, I can't understand—I get frightened when you say, for example, section 230 is an assertion of governmental control by political fiat which is at war with the principles of a free and democratic society.

That is nothing more than what they have been doing over there with respect to media-related interest. Where did we do that? So we had to find section 230 again. It has to do with what is going on at FCC now.

We have a network inquiry about the monopolistic trends with the newspaper industry and certainly no one in his right mind runs around saying, "Let's expand the limitation of the ownership of television stations beyond three stations with the FCC."

Do you know of anybody that has that bill? We have 535 hanging around town with all kinds of wild ideas but no one has been that wild.

So that is not you might say at war with the principles of the free and democratic society when we limit the ownership. That is all we are trying to do. It goes right to the point.

Many are very much afraid the phone company will come ahead with their lines and everything else and take over the cable TV business and zoom right in.

We had at least a dozen witnesses already in these areas, say, that you just make a bar to A.T. & T. getting into the cable TV business.

Let me ask specifically before I yield: Is it the intent by this comment in your statement, Mr. Preston, that Congress should make it clear by this legislation that it has mandated the industry structure which it deems appropriate for the future?

Do you really believe we will do that? In other words, that will end all the antitrust activity over at the Justice Department?

Mr. PRESTON. No, sir. I think I specifically said we weren't asking the Congress to moot the antitrust case insofar as the case alleges past misconduct.

Senator HOLLINGS. You take away the remedy of the court to divest. In other words, we determine the structure, where there couldn't be any kind of divestiture, then they might find it's monopolistic practice in violation of the antitrust procedures, thereby mandating the industry structure. What will the court order?

Mr. PRESTON. Divestiture is not the only remedy for antitrust violations if they are proven.

Senator HOLLINGS. So the divestiture remedy would remain as you see it under this act?

Mr. PRESTON. As now drawn. I think we are all tilting at windmills if we painfully legislatively construct a new structure for the industry which the antitrust court can wipe out the next day.

Senator HOLLINGS. Very good.

Senator GOLDWATER. I just have one comment.

Mr. Preston, your statement indicates that while S. 611 and S. 622 recognize the need for coordination of the planning and management of the switched public network, the legislation needs greater precision.

I won't push you at this point to elaborate on that, but I agree with you. It would be a great service to this committee if you got your legal eagles together and came up with some suggestions as to how precise this should be.

You have to keep in mind what the chairman has been saying. There is no way in the world that we can write legislation that will safely put anybody outside the purview of the antitrust monopoly laws.

I don't think we want to do it.

I believe I speak for both staffs that we would welcome any suggestion for language on the management issue.

How can competing carriers be assured that their needs will be met if they have no voice in the management of the network?

Mr. PRESTON. We would be happy to work with your staff in developing language to more adequately express what we think is the intent of all of us, both to define the network and to grant the privilege of jointly designing, managing, and operating that network by the partners who own it and provide the service.

To go to the last point you made, I think the legislation section 207 of S. 611 now explicitly requires that category II carriers must provide interconnection to any competing networks. We have said repeatedly that we are willing to provide interconnection of intercity competing networks into the exchange facilities provided by the telephone companies.

Section 207 at present is broader than that. It goes beyond that and requires joint through service to be provided between category II carriers and anybody else who wants to have joint through service.

Henry Geller urged that you not require joint through service be provided by competitors. He thought that would destroy the competitive atmosphere. We agree with that.

But your last point, Senator Goldwater, can be met by section 207 amended to be limited to requiring interconnection of intercity competing carriers into the exchange facilities of these carriers.

We are quite ready to accept that.

Senator GOLDWATER. I have asked for the same kind of help from every group that testified. This is not a field that we work in every single day.

Mr. PRESTON. We would be pleased to.

Senator GOLDWATER. That is all.

Senator SCHMITT. Thank you, Mr. Chairman.

Thank you people for your very detailed testimony. Though, occasionally, as the chairman indicated, it might seem a bit inconsistent to those of us that didn't prepare it, I am sure those inconsistencies will be clarified.

I think it's important——

Mr. PRESTON. I would be glad to respond to the inconsistency Senator Hollings thought he saw if you like.

Senator SCHMITT. If you can do it briefly, yes.

Mr. PRESTON. I said Congress should not give to the Commission the power by rule to undo the structure that Congress mandated.

The other provision I commented on is that after this massive restructuring occurs and the industry settles down, there may be mergers and acquisitions needed in the public interest.

The present act permits the Commission to hold hearings and determine whether such acquisitions and mergers are in the public interest. That provision should be continued. The present provision doesn't give the Commission the power to order any restructuring.

It merely determines whether such restructuring as the industry wants to establish is or is not in the public interest.

It substitutes Commission findings for antitrust findings.

Senator SCHMITT. I am a bit disturbed about your use of the term "massive restructuring" with respect to 622.

You say that is the purpose behind the bill. It's not. I think the only way we can justify having legislation in this area is on the basis of three needs established by these hearings.

One is that the FCC and the courts need guidance. They are acting in many issues now independent of legislative guidance.

I don't think you would disagree with that. I am not sure any part of the telecommunications industry would disagree with that.

The second reason I believe you would agree with. An increased competitive environment for both goods and services in telecommunications areas will be beneficial to consumers and industry and the Nation as a whole.

There ought to be fair competition. You would want to be authorized to the maximum degree possible to enter into that fair competition to provide the new goods and services.

Third, we want to improve and enhance the availability of all telecommunications services, and particularly basic voice services, however they may be described.

The question is: What is the legislative structure that we need to create so that those three needs can be satisfied?

One area where you have expressed the greatest concern, and I also have very great concern, is the preservation and improvement of what you now call the core network. As I understand it, you will

provide us, as I hope other witnesses will provide us, with suggestions on how we maintain and improve that core network in a competitive environment, without damage.

Not only will the staff look forward to your input, but I think several Senators will also look forward to it.

Do you have any preliminary thoughts on how a management system can be organized in a competitive environment to handle the core network that A.T. & T. now manages, without either decreasing the efficiency of that network or creating anticompetitive forces in other areas?

How do you define the management of that core network, so it continues to function and improve as it has in the past?

Mr. OLSON. I think to begin with, what the phone industry is saying is we ought to be allowed to continue to function as a telephone industry in the joint planning, design, and management of that core network that serves every part of the United States, not just the largest metropolitan areas where some of the competitors are choosing to serve. There is a public interest responsibility to make sure there is service from everywhere to everywhere.

Now I think what we have to do is to be sure—this is very much on your mind in your opening comments about the FCC and the courts need guidance, and there are many areas where increased competition will help.

There should be fair competition. Basic public service core network service which is evolving—party service looked good in 1934 but not today—is available. The trick is, and we are fully prepared, as we said in our testimony before the Senate, to make sure those competing networks, whether it's Southern Pacific, or MCI, or IBM, or whoever else enters the intercity marketplace, has fair interconnection to that core network.

I think it's important that the network the telephone industry manages today is a network under common management. It's not just Bell System management. There is a process where the telephone industry looks at an NPA area whether it's in Florida, or Chicago, or Indiana, or Iowa and looks at what is the most efficient configuration to provide service within that State to all the communities.

We attempt to go about this in a way to plan for the growth in the traffic, where the switching center should be. New technology is coming onstream, like the large digital time division switch.

We want the network to be efficient. There is competition out there. It's growing. It will grow further.

We want to be sure it's an efficient network.

Second: We want to assure it serves all the customers. The mechanism exists.

Now here is a good example of why legislation is needed—and that is why I commend the Senator for your interest. Yet another suit was just filed, I understand from testimony that was given this morning by another party in anticipation of my being here. We have now been sued again. The telephone industry, many of our partners have been sued. So we have been getting together and there is some conspiracy.

Mr. Chairman and other distinguished Senators, how will you run a network if you can't get together? There is nothing evil about what unfolded. We don't object to competition.

What we are saying is, let's not try to mix integration of competing networks into our core network. We are willing to compete with those. We will provide access, fair interconnections. One of our competitors no longer wants to compete, but he wants to be a partner. That is not competition.

There is a mechanism to make sure our public switch core network service is available to the rest of the United States, which most American citizens want. There aren't very many American citizens today utilizing the competing networks serving the major cities and big businesses.

You know that as well as I do.

I think there is a way to be sure that the competitors are treated fairly, that we will not use predatory pricing from our so-called noncompetitive services, such as local exchange or MTS to cross-subsidize what are truly competitive services like the terminal business or other specialized services coming up like DDS or ACS.

So I submit that legislation can be put together that will allow for a public switched core network to function for all Americans, enhanced over time, and yet have fully competitive services, some under a deregulated environment, and make it work.

The accounting system has to come forward.

We can do that.

So I don't see the inconsistencies of having a public switched core network service function, and I don't see the problem. There is no way you can break apart local exchange and interexchange. Those machines switch everything.

I don't think it's in anybody's interest, certainly not the average user out there, to force that.

I don't think that was your intent.

What we need to do is find the right mechanism to be sure there is fair competition and yet allow us to continue to provide that switch core network service.

Senator SCHMITT. Summarizing what you have said, if we can provide a legislative mechanism to insure fair interconnection with the core network, and if we can provide during a transition period a cost accounting system that is fair, then we can have increased competition where competition is desirable and, at the same time, maintain and improve the basic core network.

Is that a summary of your testimony?

Mr. OLSON. Yes, sir.

Senator SCHMITT. One of the most difficult parts of this is probably the accounting system. Terminal equipment may be relatively easy to put into a cost accounting system. To determine those costs may require what I think you referred to as longterm—what was that?

Mr. GOLDSTEIN. Long-run incremental costing.

Senator SCHMITT. It will be necessary to have a living statistical analysis of cost allocation in certain areas with some estimation. but also have a system that is modified with time, based on experience.

Is that what you are getting at, when you use that term?

Mr. GOLDSTEIN. Yes, sir.

Senator SCHMITT. That will probably be the most difficult part of the whole accounting system. I think you recognize that, as well as the committee does.

Now in Mr. Ross' testimony, he said certain provisions of S. 611 and S. 622 threaten to disrupt the technical integration of the telecommunications network, impede the flow of technological innovation, delay evolution of the network and new services available through it, and ultimately do a grave disservice to consumers.

I presume you mean the core network; is that correct?

Mr. Ross. Yes.

Senator SCHMITT. Impede the flow of technological innovation, could you be more specific on how S. 622 would impede the flow of technological innovation?

Frankly, one of the fundamental guidelines that the staff and I and Senator Goldwater worked with, was to try to create a mechanism that, unlike the present law, would not impede the flow of technological innovation.

If we slipped up somewhere either now or for the record, would you provide us with analysis of S. 622 and how it would impede the flow of technological innovation?

Mr. Ross. Later?

Senator SCHMITT. You might summarize it in a comment, but we would like the details and any suggestions you have for language that might remove those objections.

Mr. Ross. The concern here with S. 622 is that the Commission will determine the relationship of subsidiaries to the parent company and depending upon just what those relations are and what the structure of the subsidiary will be, then you could have an impairment of the technological area.

That was the point I was alluding to in S. 622.

Senator SCHMITT. Although we left open the possibility that an accounting system might not be possible, our presumption is that an accounting system is possible and that the formation of subsidiaries would not be necessary, except as economics made it desirable.

Is that what you are getting at there?

Mr. OLSON. I don't think S. 622 is as specific about arm's-length or a fully separate entity as S. 611.

Senator SCHMITT. I have been reading the law in the Ethics Committee for 2 years, but I am not a lawyer. Is arm's-length a term of art? Does it have a specific legal meaning to you as a lawyer?

Mr. PRESTON. I went to the books when I first read these acts, and I think the answer to your question is no, it's not a term of art and does not have any—

Senator SCHMITT. Arm's-length dealings have been in the law for a long time. I certainly heard the term well before we drafted these bills.

Mr. PRESTON. The language that troubles us is the conjunction between "arm's-length" and "as it deals with any unaffiliated entity or carrier."

The combination of the two would mean that you would have to hold your own affiliate at the same distance as you hold any

unaffiliated entity, or that you embrace the unaffiliated entity in the same way you embrace your own subsidiary.

Senator SCHMITT. You suggest that an accounting system can be established which it would make that kind of relationship unnecessary. There would be clear definition of the relationship without the necessity of treating a subsidiary as if it was also a competitor.

Mr. PRESTON. Yes. I think also that the accounting system gets to the question of cross-subsidy where subsidiary, because of the allocation of common plant, does not cover that question.

Senator SCHMITT. I thought that was a very interesting paragraph. I believe it was Mr. Goldstein's statement that even if you had subsidiaries as long as you had joint plant you have to have an accounting system.

Did I interpret you correctly?

Mr. GOLDSTEIN. Yes.

Mr. OLSON. Go to Illinois again. You have a switch that is switching both local exchange calls within the metropolitan Chicago area and delivering calls to Springfield, Ill., and Washington, D.C. Unless you are going to, in fact, hold the machinery apart and start over or reengineer the network, you would have to have an allocation of that.

What is the usage? Local usage or interexchange usage? the point Mr. Goldstein made is that separate subsidiaries, separated entities does not resolve that problem. You would have to have an accounting system. We have had one. We are saying we need a different one.

Senator SCHMITT. To allocate joint cost.

Mr. OLSON. Cost of methodology.

Senator SCHMITT. You were mandated to have this. Are you mandated without congressional intervention to have a cost accounting system? I understand you are, and you are implementing that.

The question is: Do we think it's adequate?

Mr. OLSON. This is the goal we have with the FCC and this is what Mr. Goldstein was referring to in his comments about other interested parties. If I could digress a minute about one of our difficulties before the FCC—somebody was referring to tariffs this morning. That is a poor choice of words.

We are filing tariffs based on a costing methodology that we are still trying to resolve with the FCC. We are as anxious as the FCC to find the right kind of costing methodology, the allocation process that meets their needs and meets our needs. This is very important to us.

Senator SCHMITT. I objected the other day to the general use of the term "unlawful tariffs," particularly since only a portion of the tariff is in question and also that the determining agency can't tell you what a lawful tariff would be.

Perhaps we should call it a disputed tariff or something like that, but I think the committee understands that now.

Your testimony raises another question. At certain times the network can be completely saturated or at least it can be impossible to get a call from point A to B.

I guess Three Mile Island was a good example of that, where it was impossible for some period of 40 minutes for the Governor of

Pennsylvania to call the White House. Don't you have some means, when something like that happens, to free up emergency circuits instantly?

Mr. OLSON. Why don't you address that one?

Senator SCHMITT. This has nothing to do with the legislation. I am curious about it.

Mr. TANENBAUM. If the only connection between those two points is through the switched network, it's possible for congestion to appear unexpectedly and block the network.

We have procedures we take to unblock it, but sometimes that happens.

Senator SCHMITT. If you could identify critical circuits, and when a certain level is reached, if you could switch in and hold those open——

Mr. TANENBAUM. That is what we do. We have ways of blocking calls from reaching networks, so that subsides.

First you have to get the data. Then you have to understand what is causing the problem and make the decision.

That can take 40 minutes.

Senator SCHMITT. That is on a computer program, isn't it?

Mr. TANENBAUM. We have not learned to program that yet to do it fully automatically.

Senator SCHMITT. I am surprised.

Mr. ROSS. The normal condition of the network does not evidence itself as being impossible to get a call through from one place to another. Usually you have to make repeated attempts to do that.

The full network will not fit in the biggest computer we have today, so we have to simulate that.

The dynamics are such that things build up in this 20- to 30-minute period, and you can take action in that period of time.

So you can have periods of congestion that are built up in that period of time.

It takes you that period to——

Senator SCHMITT. Can't you identify circuits critical to national security so that when a certain number of calls are being made, you automatically preserve circuit capability for priority calls?

Mr. ROSS. Yes.

Senator SCHMITT. Is that done?

Mr. ROSS. Let me be careful. We can identify through experience where the overloads in the network are liable to occur on Christmas Day and Mother's Day and that kind of thing.

Senator SCHMITT. That is based on history, not based on a disaster situation.

Mr. ROSS. There are two kinds of disasters. One, somebody puts a plow through your cable. Then you have plans to restore that by alternate routes. In those particular cases, we have identified in every cable the very critical circuits.

Senator SCHMITT. That was handled very well at the Long Lines briefing.

I am talking about the situation where suddenly the President decides to have a phone-in or people think there is a danger of family and friends being hurt by radiation. Calls come in from every direction and critical circuits become saturated without any loss of total capability in the system.

Mr. TANENBAUM. Critical circuits are usually dedicated circuits. We have a lot of those that are dedicated hot-line circuits between people who know they may need to communicate with each other.

One of the potentials in the stored program controlled network is at least the feasibility of identifying certain particular numbers, which under certain conditions can be given priority to work their way through the network.

I think that is a feasible kind of service that is not available now.

Senator SCHMITT. I encourage you to continue to examine that and maybe give it more priority than you have in the past.

There are many situations where that may be important.

Mr. Ross. Indeed.

Senator HOLLINGS. Senator Exon.

Senator EXON. Thank you, Mr. Chairman. As is quite clear in these hearings, many of the matters I had to inquire about have already been asked. I first want to compliment you gentlemen and also the panel this morning for enlightening us on these matters. One of the problems we have here in Washington, D. C., we probably lack the technical expertise necessary to try and redo a communications system in the United States.

That is one of the things that concerned me a great deal. I have responsibility to make amendments or vote pro or con on these things that come up.

I want to compliment you all for helping us, especially Mr. Preston.

By comparison, your testimony was the shortest of all those given here today.

I think that is quite significant, because usually lawyers are not that brief.

I wish the brevity you experienced could be passed along to the members of your profession who serve in the U.S. Senate.

That isn't possible.

I have a question or two for you. Maybe Mr. Olson, you could best respond to this. I was worried a little bit more about what I am about to ask you, as a result of the answer to Senator Schmitt's question with regard to the emergency in Pennsylvania.

It was my assumption that the telephone network that we recognize as efficient and the best in the world—I would caution you we expect our system to be the best in the world.

We are the best in the world in most things. Just because we have a telephone network that is the best in the world, I don't think we should hoist the flag too high in defense of the system as it presently exists.

I also thought, though, that our vital defense functions, such as SAC in Omaha and some of our other major real emergency centers were backed up quite efficiently by the common carriers as they presently exist.

Would you comment on that?

Mr. OLSON. They are. As you know, there are many special governmental networks. Maybe I could talk more specifically to some of them. They go from the FTS network all the way to the many defense networks that I don't think we should be talking about.

Some are more on the top secret level. What we do have is facility backups and restoration plans.

About Three Mile Island that Senator Schmitt was talking about—I would be glad to leave a publication here that describes what the telecommunications industry did during that emergency, including United Telecommunications serving adjacent to Bell of Pennsylvania.

So, yes, we do have backup facilities.

We have restoration plans.

Of course, as I said, we have many of the governmental networks that are separate and distinct. I assure you we work closely with the Defense Department and all arms of the Government to be sure the network that exists out there today will respond under all conditions.

What took place in Pennsylvania was the same thing that took place in Wichita Falls, Jackson, and in my stamping grounds in North Dakota, where we have to move in directional circuits. We have numerous plans on how to deal with that kind of emergency.

As Dr. Tanenbaum was suggesting, with some of our new systems coming onstream we will have even more capability of being sure the network will function under these conditions.

Senator EXON. As a member of the Armed Services Committee, I am very much concerned about our national defense posture in general.

Let me ask you this as a followup question:

Do you believe any parts of the two principal measures before the U.S. Senate that you are testifying on here today—would anything in those particular measures, in your opinion, have any disruption of the secure telephone network we have available, and the backup facilities that are used by our overall Defense Establishment today?

Would these bills have any adverse effect there?

Senator HOLLINGS. Let me start and ask Dr. Ross and Dr. Tanenbaum to add to it.

Dr. TANENBAUM. The biggest concern we have is that the public core switched network be allowed to be managed as an entity. If you don't have that, in my judgment, you're jeopardizing some of the very points that you made. If, in fact, we can continue to run a public core switched network under a single, unitary management, and that management is the telephone industry, I think you can find ways for all kinds of competition to exist in an equitable way and still make sure there is this core network that not only serves the American public but does take care of some of your concerns from the national defense perception.

Senator HOLLINGS. Dr. Ross, do you want to add anything to that?

Dr. Ross. From a technical design point of view, it's imperative in designing a secure network that you design it from end to end, from terminal to terminal, as I said, and if for any reason that expertise were lost, it could impair the ability to put together a secure network.

Senator EXON. I just want to say in closing to encourage you as I encourage some of the other members of the panel that see things differently than most of you gentlemen do, to follow up on a

suggestion made by Senator Goldwater a few moments ago, and that basically is it seems to me that we generally have to have a recognition that we have to have somebody in charge of the overall telephone communications system in the United States. In saying that, I don't mean that I would be against legitimate types of competition coming in on a legitimate basis that in some instances would have to be tied into your networks. You testified today you think that's possible. I would encourage you to come up with language we could look at here. At least this member of the committee doesn't have any expertise in the very complicated switching arrangements you have now, and I'm fearful that we might pass something in an act that would indeed complicate our overall communications system and the telephone industry. We need your help and some objective suggestions in language that we might be able to approve that would accomplish generally the goals and ends of both A.T. & T. and its subsidiaries and your emerging competitors. Give us some help.

Mr. OLSON. We will. We appreciate your interest. You raised a question about the Canadian network. If you don't object, I might have Morrie Tanenbaum respond to how it functions up there.

Senator HOLLINGS. Very good. Go ahead.

Dr. TANENBAUM. Mr. Chairman, again we come back to the fact that it's not so much a question of subsidiaries or not subsidiaries. It's a question of how those subsidiaries can work with each other.

A.T. & T. has been pointed out as having lots of subsidiaries. I'm president of one of them. Although I'm president of a separate subsidiary, I work hand in hand as part of the planning team with the other Bell System operating companies and with long lines—not in a competitive way but in a cooperative way—to build the overall network. That's how we work with Canada. That's how the organization in Canada that has responsibility for all the trans-Canada operations works with Bell Canada and the other provincial telephone companies there. That, of course, is how we try to work with our international partners because we're not in a competitive arrangement. We are in a partnership arrangement. We provide individual service in certain areas. They provide service in certain areas.

It is in our overall enlightened self interest that we do this planning together and the real thing that has been troubling us, as I'm sure you detected, is exactly what is meant by a term such as arm's-length and in what way would we be permitted to work together both organizationally and technologically if new subsidiaries were formed.

Senator HOLLINGS. How do you define core network?

Dr. TANENBAUM. I define it as the principal part of the network from the first switching machine to the switching machine at the terminating end, or the switching machine where the calls originate to the one where the calls terminate—that is the public switched network where one can selectively choose any point he wants.

Senator HOLLINGS. For all services?

Dr. TANENBAUM. Certainly for MTS services, for voice services.

Senator HOLLINGS. Only MTS?

Dr. TANENBAUM. The same network can be used for many other services. The same network can be used for data services through Dataphone. It can be used for all kinds of services, because it is there.

I might also say, though, that as the technology moves, that definition can be a changing definition and it has been a changing definition in the past. Before we had switching machines, when everything was manual, the kind of constraints you had were altogether different. Now as we look at the next generation, we will have distributed switching machines with some parts of those machines out near the customer. The needs for compatibility and the requirements for planning will change. There is great danger in remembering to define in today's physical terms exactly what that core network is. That's one of the problems we have.

Senator HOLLINGS. Dr. Ross, with respect to Bell Labs, I think you can agree Bell Labs is a national asset. I wonder how you allocate the calls with respect to any commodity going into the competitive field—are you financed generally one half Western Electric and one half the operating companies? How is Bell Labs financed?

Dr. Ross. You're quite correct. Our present financing happens to be roughly 50 percent from Western Electric and 50 percent from the operating telephone companies, either directly or through A.T. & T.

Senator HOLLINGS. Most of the benefits go to Western Electric?

Dr. Ross. The benefits from the 50 percent paid for by Western Electric go to Western Electric and the benefits from the other 50 percent financed by the phone companies go to the phone companies and A.T. & T.

Senator HOLLINGS. Roughly an equal distribution of benefits as well as financing the costs; is that what you're saying?

Dr. Ross. The budget—our expenses are determined by the work we do. The work we do in support of the design of the product is charged to Western Electric.

Senator HOLLINGS. The switchboard you might sell in the field of competition, how would you allocate the cost to Bell Labs? How do you allocate the research and development of the equipment entering the market of competition?

Dr. Ross. Any work we do that is in support of a development of a specific product like a switching machine is charged to Western Electric and goes into their accounting system to determine pricing on that machine.

Now let me point out—

Senator HOLLINGS. That wouldn't be an added burden by this bill. We will have to look at the arm's-length expression that worries you and the attorneys for Bell Labs. But in essence, there is no intent to break up Bell Labs. Yet you say there is no difficulty accounting-wise because at the present time what you do is allocate the cost to any kind of equipment that finds itself in the competitive market as far as R. & D. for that at Bell Labs, you have an itemization over there that I could look and find right now?

Dr. Ross. Yes, sir. Let me point out that we have considered the Western Electric product, all of it, to be competitive for a long time.

Mr. OLSON. It might be helpful if you again permit us to hear from Mr. Goldstein, whose written response deals with Bell Laboratories and how those costs get back out, the portion the company pays and how that ends up in the various services and products that are offered by the whole telephone company.

Senator HOLLINGS. Go right ahead.

Mr. GOLDSTEIN. As Dr. Ross said, the work that Bell Laboratories does to design Western Electric equipment is charged to Western Electric. Western Electric then applies that cost—this is now a cost to Western Electric. Western Electric now applies that cost to a product line that this particular piece of equipment is in. It is then allocated to that particular product and it is part of the price that the operating company pays for that particular piece of equipment.

In turn, the cost of the service that this piece of equipment is used in includes the cost of the piece of equipment and is charged to the ultimate customer. So the money the customer pays goes through the operating company through Western Electric to Bell Labs specifically for the piece of equipment that was designed by Bell Labs.

I don't believe we have the kind of accounting problem that we've talked about, the cost accounting problem, in either Bell Labs or Western Electric. There is a cost accounting problem that is confined to the operating telephone company.

Senator HOLLINGS. Do you have anything else?

Senator EXON. Nothing more. Maybe one more thing. The chairman I think responded quite well—I was surprised by your words "war with the principles of a free and democratic society." I'm not aware of any power as broad as this surviving the constitutional test. Is that a signal that A.T. & T. will be suing under constitutional statutes if this law is passed as proposed?

Mr. PRESTON. I certainly hope that there will be no occasion for that.

Senator HOLLINGS. Very good.

Senator EXON. I did want to make a statement that none of us here are trying to be abusive to A.T. & T. or anyone else, but I emphasize once again that unless we have your expertise to break through some of the concerns we have, a company as large as A.T. & T., while I don't agree with it, there is a madness loose in the country today that anything big is bad. I emphasize that we need your help and your expertise and understanding in some of these areas where the public is demanding we have more competition than we have now. I thank you.

Mr. OLSON. Mr. Chairman, if you would permit 2 minutes, I would like to summarize from our point of view if it's all right with you.

Senator HOLLINGS. Go ahead.

Mr. OLSON. I would like to summarize some of the points which we have tried to bring to your attention in amending the Communications Act. We do hope it's now clear the Bell System is ready to face the future with an open mind. The telephone industry is willing to make an all-out effort to accommodate new goals and

new directions in telecommunications. The telecommunications industry needs legislation which clearly states national policy and clarifies the ground rules. The people of the country deserve legislation. They have a right to know what service will be available in the future, from whom and on what conditions.

Properly approached, we do believe that universal low cost service can continue to be available in the future environment of increased competition. The features of that competition are becoming clear. The terminal equipment market has already been opened fully to competition and appears to be appropriate for the deregulatory steps taken in both bills.

We believe that multi inter-tercity networks can coexist and compete and we are prepared to provide fair interconnection with such networks to the local exchange portion of our network.

The bill should clearly state the obligations to interconnect networks to assure that the basic public network is protected. Networks don't run themselves. They must be engineered and we believe the ability of network owners to do that should be clearly assured, whether it's MCI, Southeastern Pacific or the telephone industry. Fair competition can and must be assured and the Bell System is committed to the promptest possible development of a cost accounting system which clarifies specific costs and associates them with specific products and services.

Legislation should mandate the adoption of such a system and should likewise prescribe the economic methodology to be used in pricing services and products to assure that competition will exist and will be fair. Interim protection can be assured by requiring carriers, where applicable as a condition of entry into a new market, to establish segregated accounts for new services and to substantiate prices with cost data based on prescribed studies. Further protection, if needed, can be obtained through a requirement of new corporate subsidiaries for the purpose of assuring fairness in the marketplace. This should be in the form of a delegation of authority to the Commission outlining the objectives of such a requirement and the circumstances and conditions where the exercise of the authority might be appropriate.

Such structural changes, however, should be achieved without establishing barriers to technological or operational deficiencies. In no event should the FCC be empowered to order divestiture.

Finally, we agree that continued regulation is needed to assure basic services but such regulation ought to be kept to the minimum and should be phased out when market forces take over. In short, Mr. Chairman, we believe that we all share common objectives. We are of the opinion that the 1934 act is basically sound but needs to be updated to reflect circumstances and new technologies. S. 611 and S. 622 can be amended into a piece of workable legislation under which the Nation's new telecommunications objectives can be achieved.

We appreciate the time you have allowed us today.

Senator HOLLINGS. We appreciate you and your colleagues coming here. Thank you very much.

The committee will be in recess until 10 in the morning.

[Whereupon, at 4:30 p.m., the hearing was recessed, to be reconvened at 10 a.m., May 3, 1979.]

AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

THURSDAY, MAY 3, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 10:10 a.m. in room 235 of the Russell Senate Office Building, Hon. Ernest F. Hollings (chairman of the subcommittee) presiding.

Senator HOLLINGS. Good morning.

We have for our people this morning, Mr. Theodore F. Brophy, Paul Henson, Robert Bunke, Richard Hostetler, and Wallace Doud.

We welcome you here. Mr. Brophy, will you start off for us, please? We have the 10-minute rule. I think you are familiar with that. We will give each of the people 10 minutes for his statement. The yellow light shows when you have 1 minute remaining. We will come back if you have not finished your statement. This will give everyone a chance to get in his main points, and we can have further discussion.

STATEMENTS OF THEODORE F. BROPHY, GENERAL TELEPHONE & ELECTRONICS CORP.; PAUL H. HENSON, UNITED TELECOMMUNICATIONS, INC.; ROBERT W. BUNKE, USITA; RICHARD C. HOSTETLER, WESTERN UNION TELEGRAPH CO.; AND WALLACE C. DOUD, INTERNATIONAL BUSINESS MACHINES CORP.

Mr. BROPHY. Thank you, Mr. Chairman and Senator Goldwater.

Mr. Chairman, members of the subcommittee, my name is Theodore F. Brophy, and I am chairman and chief executive officer of General Telephone & Electronics Corp., known as GTE.

We applaud your efforts to bring to our Nation's telecommunications system the benefits of fuller and fairer competition while reducing, wherever possible, the burdens of needless Government regulation.

In fact, however, there is no need to replace in its entirety the Communications Act of 1934 or even amend it merely in order to introduce competition. As a result of FCC changes in regulatory policy, competition is already being introduced into all phases of our telecommunications system. In light of these changes, however, the 1934 act does not need to be amended to protect important interests of the public. We are pleased that both S. 611 and S. 622 are based on the concept that change can be accomplished by appropriate amendments rather than by a total rewrite.

In the very brief time I have this morning, I will touch on just five of the areas in which we have concerns. Before the close of the record in these hearings, I also would like to submit an expanded written statement.

My first concern is the integrity of the nationwide public switched telecommunications network.

We believe that it is imperative that telephone companies jointly continue—as provided in sections 201 and 203 of the present act—to own, operate, plan, manage, and construct that network. There would seem to be only three conceivable ways in which these important network functions might be performed:

First, jointly by the telephone companies, all of which have a common interest in the operation and the economic and technological integrity of the network.

Second, by all of the communications companies, including competitors—among whom there would be no common interest.

Third, by the Government.

I suggest that only the first of these three alternatives is viable.

Neither S. 611 nor S. 622 seems to recognize the inherent contradiction that would be created by the inclusion of competitive non-telephone company carriers in the planning process, and the risk to quality of services.

In addition, provisions of S. 611 describe circumstances requiring separate subsidiaries. These could be read to require five separate corporations in order to provide local service, terminal equipment, message toll service, private line service and international service—all of which today can be offered by one company. Such a requirement would certainly work against planning efficiency.

Since the introduction of Execunet, Sprint, and now City-Call services, message-toll and wide-area telephone service face direct, destructive competition on heavy usage, low unit-cost routes.

Statutory standards must be established now for providing competitive interexchange service. Appropriate mechanisms must be developed for regulating points of connection to local exchanges, and for deriving access charges for interexchange use of local distribution facilities. Recognition must be given to the need for an orderly transition if there is to be a nondisruptive move from a regulated monopoly environment to free and open competition in interexchange services.

S. 611, S. 622, and H.R. 3333—as well as Assistant Secretary Henry Geller in his statement submitted to the subcommittee in conjunction with his testimony on April 24—recognize that local service, at least for an extended period, will be provided as a regulated service. If the mandate of universal service set forth in the 1934 act is to continue, as all three bills indicate it should, there must be a carrier of last resort to provide local-exchange service.

Such a concept is inconsistent with the concept of competition at the local-exchange level. If efforts are made to encourage more than one supplier of interconnected telecommunications service within the same local exchange, the inevitable result will be duplication and inefficiency, and in some areas, withdrawal of service.

Whether at some time in the future the local exchange monopoly should be eliminated is not an issue that Congress must or should

attempt to judge by imposing an application of the sunset concept to local-service regulation at this time.

The second area of concern I would like to discuss today is that of terminal equipment competition.

If there is to be unregulated competition in the provision of terminal equipment, you must first establish mechanisms to permit capital recovery of the existing investments of the telephone companies.

There must also be provisions that assure the right of telephone companies to provide terminal equipment by either lease or direct sale, without the need for establishing costly, separate entities if they are to compete effectively.

The third point I would like to emphasize today, is the need to insure that competition, as it is introduced, is genuine, full, and fair. If the public is to benefit from competition, the telephone companies themselves must be permitted to compete rather than being handicapped, as has been the experience under certain decisions of the FCC to date.

It appears that some of the provisions of S. 611 might hinder, rather than promote, full and fair competition. One example is the regulation of so-called category II carriers, as opposed to category I carriers, even though both categories of carriers will be expected to compete for some of the same business. We are confused and troubled by the absence of specific criteria to be used in determining whether a company is a category I or category II carrier, and find the bill ambiguous as to whether a company may fall partly into each category. We believe that unguided authority vested in the Commission by either of these bills would invite protracted litigation and better serve the interests of the legal profession than the public.

Fourth, we believe that one major amendment to the 1934 act is long overdue. That amendment would divide the FCC into two agencies, one focusing on broadcasting and the other on telecommunications. These two extremely complex and important industries have unique and unrelated problems. It is unreasonable to expect that any group of Commissioners can develop adequate expertise in both fields. The quality of regulation would be greatly enhanced by separating the agency into two separate and specialized agencies.

My fifth and most important point is a general statement of principle: Major change, however well intentioned, always produces unanticipated results. The greater the change, the greater the uncertainty. When something as vital and complex as our telecommunications system is subject to massive change in regulatory philosophy, there is a great risk that unforeseen effects will result in a degradation of service and economic discontinuities.

We therefore earnestly request that the subcommittee carefully evaluate the public benefits, costs and risks that will be created by each proposed change, and remember that all changes need not be achieved at once. A sequential addressing of objectives in the order of priorities may well prove to be the least disruptive approach.

Airline industry experiences since passage of the Airline Deregulation Act of 1978 illustrate this point very well. That act's long-term effect is still uncertain, but short term results have included

schedule disruptions and flight reductions. Several times in your speeches, Mr. Chairman, you have commented on the impact so far on your home State of South Carolina.

The airlines can suffer short term operational degradation with annoying and temporary inconvenience for only a limited number of consumers. Telephone service impacts almost every man, woman, and child in the United States, and I do not believe this Nation is prepared to accept such degradation of service in its telephone system.

Compared to the airlines system, our Nation's telecommunications system is vastly more complex. It is continually able to affect more people more profoundly, and, should anything go awry, it will be much more difficult to restore.

I want to thank the subcommittee for allowing me to share these brief views with you. We welcome the opportunity to work with you and your staff and to provide whatever information and support may assist you in your deliberation.

[The statement follows:]

**STATEMENT OF THEODORE F. BROPHY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER,
GENERAL TELEPHONE & ELECTRONICS CORP.**

Mr. Chairman, Members of the Subcommittee, my name is Theodore F. Brophy, and I am Chairman and Chief Executive Officer of General Telephone & Electronics Corporation, known as GTE. GTE's domestic telephone subsidiaries serve almost 14.5 million telephones in the United States, making it the largest Independent (non-Bell) telephone system. GTE is also a major manufacturer of a wide variety of communications, electronic, lighting, and related products.

I appreciate this opportunity to present some observations on the challenging task you have undertaken in amending the Communications Act of 1934.

We at GTE welcome your involvement in an issue of enormous importance to all Americans. Several years ago, we—along with others in the telephone industry—stated our belief that Congress should assume the dominant role in any effort to restructure the Communications Policy of the United States. You have accepted that difficult role and we welcome an opportunity to be of assistance to you.

I must confess that I also feel that my own role today is difficult. It is not possible in ten minutes to comment in detail on the three bills, S. 611, S. 622 and H.R. 3333, which alone cover nearly 400 printed pages. The difficulty is compounded when one considers that these bills are designed to amend or replace a comprehensive scheme of legislation that has been in effect for 45 years and that has been subject, during that period, to regulatory and judicial interpretation in decisions covering thousands of pages.

Nevertheless, we applaud what we see as the main thrust of your legislative efforts—as well as the efforts of your counterpart subcommittee in the House of Representatives. You are working to bring to our nation's telecommunications system, where appropriate, the benefits of fuller and fairer competition, while reducing, whatever possible, the burdens of needless government regulations.

This is a cause with which no one who believes in the American free enterprise system can have any basic quarrel. Certainly, you will have none from GTE—a corporation with considerable experience operating in both worlds: as a regulated utility, to be sure, but also as a competitor in the free marketplace.

In fact, however, there is no need to replace in its entirety the Communications Act of 1934 or even amend it merely in order to introduce competition into our telecommunications system. Such competition is already being introduced. Nevertheless, we believe that, in light of the recent changes in regulatory policy designed to introduce competition, the 1934 Act does need to be amended to protect important interests of the public. We are pleased to see that both S. 611 and S. 622 are based on the concept that whatever changes are needed can be accomplished by appropriate amendments, rather than by a total rewrite.

Before undertaking the task of drafting amendments, however, one must first determine what objectives are to be achieved and place those objectives in order of priority. One must then determine how the objectives can best be achieved at the least cost to the public and with the firm assurance that change will not result in degradation of service. We do not believe this step-by-step approach has been taken.

In my oral statement this morning, I will touch on just a few of our specific concerns. I hope that I may have an opportunity to expand on them during the question-and-answer period. Before the close of the record in these hearings, I also would like to submit an expanded written statement. Within the last week, two other GTE witnesses have appeared at these hearings: Dr. Lee Davenport, discussing new technical developments, and Mr. Roy Bahnson, discussing access charges. Later this month Mr. Donald Kuyper, President of our subsidiary, Hawaiian Telephone Company, will speak to you on international issues.

If the present Communications Act is to be usefully amended, there are several points that will require your most careful and precise attention. This morning let me touch on only five of them.

The first concerns the integrity of the nation-wide public switched telecommunications network, in both its interexchange and its local service aspects.

We believe that it is imperative that telephone companies jointly continue—as provided in Sections 201 and 203 of the present Act—to own, operate, plan, manage and construct that network. There would seem to be only three conceivable ways in which these important network functions might be performed:

1. Jointly by the telephone companies, all of which have a common interest in the operation and the economic and technological integrity of the network.

2. By all of the communications companies, including competitors—among whom there would be no common interest.

3. By the government.

We believe that objective analysis leads one to the conclusion that only the first of these three alternatives is viable.

I cannot overemphasize the importance to our nation of the availability of adequate communications service through the network concept. Neither S. 611 nor S. 622 seems to recognize the inherent contradiction that would be created by the inclusion of competitive non-telephone-company carriers in the planning process, and the risk to quality of services. In addition, provisions of S. 611 describe circumstances requiring separate subsidiaries; these could be read to require five separate corporations, to provide local service, terminal equipment, message toll service, private line service and international service—all of which today can be provided by one company. Such a requirement would certainly work against planning efficiency.

There has been considerable turmoil surrounding the introduction of interexchange competition—particularly since the introduction of Execunet and Sprint Services in the mid-1970's, along with the courts' decisions overruling the FCC and permitting such services to be offered. Message-toll telephone service (MTS) and wide-area telephone service (WATS) are today facing direct competition on those routes which have heavy usage and low unit-cost.

We believe that, as a result of these developments, the 1934 Act must be amended to establish the standards for providing competitive interexchange service. For example, appropriate mechanisms must be developed for regulating the points of connection to local exchanges; for deriving access charges to be paid for interexchange use of local distribution facilities; and recognition must be given to the need for an orderly transition from a regulated monopoly environment to one in which there is to be free and open competition in the supply of interexchange services.

Any amendments to the 1934 Act that deal with the question of jurisdiction over local-exchange service must be precise in their definitions. S. 611, S. 612 and H.R. 3333 all recognize that local service, at least for an extended period, will be provided as a regulated service. If the mandate of universal service set forth in the 1934 Act is to continue, as all three bills indicate, then we believe that there must be a "carrier of last resort" providing the local-exchange service. Such a concept, we suggest, is inconsistent with the concept of competition at the local-exchange level. If efforts are made to encourage more than one supplier of interconnected telecommunications service within the same local exchange area, the inevitable result will be duplication and inefficiency, and in some areas, withdrawal of service.

Assistant Secretary Henry Geller, in his statement submitted to the Subcommittee in conjunction with his testimony on April 24, recognized these important points. Concerning local service, Mr. Geller stated: "Because of the existing monopoly, and in recognition of the possible 'natural monopoly' characteristics of the local-exchange market, we recommend continued regulation of local-exchange services as long as the monopoly exists." He said: "Although competitive substitutes for this basic local exchange service may eventually appear . . . their technical and economic feasibility is still uncertain."

Whether at some time in the future the local exchange monopoly should be eliminated is not an issue that Congress should attempt to judge now by imposing an application of the Sunset concept to local-service regulation.

The second area of concern I would like to discuss today is that of terminal equipment competition.

S. 611 and S. 622 both talk in general terms of "deregulating" terminal equipment. We suggest that this approach is inadequate for such a complex subject. If there is to be unregulated competition in the provision of terminal equipment, we must first establish mechanisms to permit capital recovery of the existing investments of the telephone companies. Such mechanisms might include provisions similar to Section 225(d)(2)(E) of S. 622, which would accelerate existing depreciation schedules. In addition, there must be provisions permitting the recovery of such accelerated depreciation in the established rate schedules.

Furthermore, if telephone companies are to compete effectively in the terminal equipment area, there must be provisions that assure the right of telephone companies to provide terminal equipment by either lease or direct sale, without the need for establishing costly, separate entities.

The third point I would like to emphasize today is the need to ensure that competition, as it is introduced, is genuine, full and fair. If the public is to benefit from competition, the telephone companies themselves must be permitted to compete instead of being handicapped, as has been the experience under certain decisions of the Federal Communications Commission to date.

It appears that some of the provisions of S.611 might hinder, rather than promote, a system of full and fair competition. One example is the regulation of so-called "Category II" carriers, as opposed to "Category I" carriers, even though both categories of carriers will be competing for the same business. We are confused and troubled by the absence of specific criteria to be used in determining whether a company is a Category I or Category II carrier, and find the bill ambiguous as to whether a company may fall partly into each category. In this and other areas of the bills, we find insufficient guidance given to the Commission. By apparently vesting unlimited authority in the Commission to classify carriers and services, we believe either these bills would invite protracted litigation and better serve the interests of the legal profession than the public.

In S. 622 the provisions permitting the FCC to regulate the amount by which competitive rates can be raised or lowered also seems inconsistent with the concepts of competition.

Fourth, we believe that one major amendment to the 1934 Act, though long overdue, is not covered by any bill now being considered. That amendment would divide the FCC into two agencies, one focusing on broadcasting and the other on telecommunications. These two extremely complex and important industries have unique and unrelated problems. It is unreasonable to expect that any group of commissioners can develop adequate expertise in both fields. We believe that the quality of regulation would be greatly enhanced by separating the agency into two separate and specialized agencies.

The fifth and most important point I would like to make this morning is a general statement of principle: Change, however well intentioned and directed to whatever worthy end, always produces unanticipated results. The greater the change, the greater the uncertainty, and when something as vital, as complex, and ubiquitous as our telecommunications system is subject to massive change in regulatory philosophy, there is a great risk that unforeseen events will result in a degradation of service and economic discontinuities. We therefore earnestly request that the subcommittee carefully evaluate the public benefits and costs that will be created by any proposed changes. In this way, the changes will more likely be limited to those needed for specific and clearly defined objectives. Nor must all objectives be achieved at once. A sequential addressing of objectives in the order of priorities may well prove to be the least disruptive.

The experience in the airline industry since passage of the Airline Deregulation Act of 1978 illustrates this point very well. No one can say for certain what the ultimate outcome of airline deregulation will be. It can be said with assurance that the short-term results have included some schedule disruptions and flight reductions. Several times in your recent speeches, Mr. Chairman, you have commented on the impact so far on your home state of South Carolina.

Many American industries, including the airlines, can suffer short-term operational degradations and disruptions, and the result is only an annoying and temporary inconvenience for certain consumers. Telephone service impacts almost every man, woman, and child in the United States, and I do not believe this nation is prepared to accept degradation of service in its telephone system.

Compared to the airlines, our nation's telecommunications are vastly more complex; they are continually able to affect more people more profoundly; and, should anything go awry, they will more difficult to restore.

I want to thank the Subcommittee for allowing me to share these brief views with you. We welcome the opportunity to work with you and your staff and to provide whatever information and support may assist you in your deliberations.

[The following information was subsequently received for the record:]

GENERAL TELEPHONE & ELECTRONICS CORP.,
Washington, D.C., June 19, 1979.

Re Hearings on Bills to Amend the Communications Act of 1934.

Hon. ERNEST F. HOLLINGS,
Chairman, Subcommittee on Communications, Committee on Commerce, Science, and Transportation, Russell Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I am transmitting herewith the statement on behalf of General Telephone & Electronics Corporation (GTE) supplementing the oral testimony of GTE's chairman of the board, Theodore F. Brophy, before the Subcommittee on May 3, 1979.

We request that the supplemental statement be printed as part of the hearing record.

Respectfully yours,

WILLIAM MALONE,
Vice President.

Enclosure.

SUPPLEMENTAL STATEMENT OF GENERAL TELEPHONE & ELECTRONICS CORP. ON COMMUNICATIONS ACT AMENDMENTS

INTRODUCTION

During April, May and June, 1979, the House and Senate Communications Subcommittees each conducted hearings on the bills which would revise the Communications Act of 1934—S. 611, S. 622 and H.R. 3333. The hearings included testimony and prepared statements by a variety of companies, associations, and state and federal government entities on the various aspects of telecommunications structure in the United States and what modifications, if any, to the Act would be appropriate.

GTE actively participated in the House and Senate hearings. This GTE Statement supplements the testimony of GTE witnesses.

Comments are submitted on the following areas of concern:

1. Nationwide Public Switched Telecommunications Network (NPSTN)
 - (a) Local Exchange
 - (b) Intraexchange Charges: Access Charges and Contribution
2. The "Full Separation" Requirement
3. Terminal Equipment Deregulation
4. International Telecommunications
5. Broadband/CATV Services
6. Spectrum Matters
7. Bifurcation: Creation of a separate Federal Telecommunications Commission

NATIONWIDE PUBLIC SWITCHED TELECOMMUNICATIONS NETWORK

It is imperative that telephone companies continue to jointly own, operate, plan, manage and construct the nationwide public switched telecommunications network (NPSTN). The network is an essential national resource. It is the sole means of providing universal communications service and thereby plays an important part in protection of life and property, energy conservation, and national defense.

The United States has generations of experience with this system. All things considered, it has proved highly successful—as reflected in the quality of telephone service in this country and its reasonable cost.

The importance to our nation of the availability of adequate communications service through the NPSTN cannot be overemphasized. S. 611, S. 622, and H.R. 3333 do not seem to recognize the inherent contradiction that would be created by the inclusion of competitive non-telephone company carriers in the network planning and management process, each striving to accomplish its own ends, and the risk to quality and efficiency of service which would inevitably result.

Involvement of non-telephone company carriers in network planning and management would create a very strange environment for a constructive planning process. The "partners" in the creation and operation of the NPSTN would be required to

work with the proprietors of competitive networks—parties having entirely different and even, in some cases, opposing interests. The practical and legal complications which would arise should remove from serious consideration any such involvement.

The maintenance of the integrity of the NPSTN is not inconsistent with the provision of competitive interexchange services. But appropriate mechanisms should be developed in such areas as: the points of connection to local exchanges; deriving access charges to be paid for interexchange use of local distribution facilities; and an orderly transition from a regulated monopoly environment to one in which there is to be free and open competition in the supply of interexchange services.

LOCAL EXCHANGE

S. 611, S. 622, and H.R. 3333 all recognize that local service, at least for an extended period, will be provided as a regulated service. If the mandate of universal service set forth in the 1934 Act is to continue, as all three bills indicate, then GTE believes that there must be a "Carrier of last resort" providing the local-exchange service. Such a concept is inconsistent with the existence of competition at the local exchange level. If efforts are made to encourage more than one local supplier of interconnected telecommunications service within the same local exchange area, the inevitable result will be duplication and inefficiency and, in some areas, withdrawal of service.

Henry Geller, the Assistant Secretary for Communications and Information, Department of Commerce, in his statement submitted to the Senate Subcommittee on April 24, 1979, recognized this problem. Mr. Geller stated: "Because of the existing monopoly, and in recognition of the possible 'Natural monopoly' characteristics of the local exchange market, we recommend continued regulation of local exchange services as long as the monopoly exists."

Mr. Geller also said: "Although competitive substitutes for this basic local exchange service may eventually appear . . . their technical and economic feasibility is still uncertain."

Whether at some time in the future the local exchange monopoly should be eliminated is not an issue that Congress should attempt to judge now by imposing an application of the "sunset" concept to local service regulation.

In addition, it should be recognized that the configuration and definition of exchange areas have historically been determined to reflect the actual growth or change in the communities served. Each modification of exchange boundaries has been a joint effort initiated by the telephone company and concurred in by the state regulatory authorities. This procedure has served the public interest and should be retained.

INTRAEXCHANGE CHARGES: ACCESS CHARGES AND CONTRIBUTION

Under present settlement and ratemaking arrangements, local telephone companies are reimbursed for costs of originating and terminating interexchange (toll) services over their exchange facilities. They are also reimbursed for costs associated with interexchange facilities used for services provided jointly with other NPSTN carriers. All of these costs are recovered from a "pool" of toll revenues derived from toll rates based on: directly identifiable interexchange costs; the traffic-sensitive exchange costs associated with interexchange traffic; and an allocated portion of the non-traffic-sensitive exchange costs. The non-traffic-sensitive exchange costs are allocated to toll using a formula which attributes considerably more of these costs to the average toll call than to the average local call.

The reimbursement of the traffic-sensitive portion of exchange costs is generally recognized as economically rational because it is based on a cost-causation attribution formula. Since non-traffic-sensitive costs do not vary with the level of demand for a particular service (toll or local), their allocation to toll is arbitrary from an economic standpoint. Reimbursement for these non-traffic-sensitive exchange costs from toll revenues can be viewed as a "contribution" to keep rates for local service lower than they would be otherwise.

The GTE concept is that all providers of non-NPSTN interexchange services which directly or indirectly connect with local exchange facilities be required to reimburse local exchange carriers, by means of an access charge, for use of such facilities. This charge should eventually reflect only exchange switching and trunking costs that vary with the amount of interexchange traffic carried over the exchange facilities (traffic-sensitive costs). The "contribution", or allocation of the cost of non-traffic-sensitive exchange plant, should be gradually reduced during a transition period and eventually excluded from the non-NPSTN access charge and from the NPSTN toll allocation. All non-traffic-sensitive exchange costs should in

the long term be supported directly from rates paid by the local telephone exchange customer.

With the advent of increasing competition in interexchange markets, the NPSTN carriers will be forced to align price more closely with cost for interexchange services. Since changes in demand for these services do not change the level of non-traffic-sensitive exchange costs, an economically rational price for these services should not include the cost of non-traffic-sensitive facilities.

The GTE concept would, in the long term, eliminate the allocation of non-traffic-sensitive exchange costs to any interexchange service. By eliminating this allocation, NPSTN costs chargeable to MTS and WATS could be reduced and better market equilibrium maintained between these and competing services.

Further, the elimination of the "contribution" from access charges would permit these charges to be set at a lower, more competitive level. The access charge will be affected by both technological and market factors. Technologies exist today, such as roof-to-roof antennas, that need no direct connection to the network. If the access charge were to include an element for contribution to help cover the costs of local exchange facilities, and the access charge is perceived to be too high, interexchange service providers will seek to bypass local telephone facilities to provide service. As this diversion occurs, the interexchange contribution to non-traffic-sensitive exchange costs will be lost. In addition, support for traffic-sensitive exchange facility costs will be diminished.

GTE recommends that any legislation enacted by Congress reflect the following:

1. To the extent possible, charges for specific services should be based on the demand/cost characteristics of those services.

2. Overhead costs, which include costs of ticketing and administration, should be recovered from the cost causer.

3. Any contribution to defray the costs of non-traffic-sensitive subscriber access facilities should be eventually eliminated from charges to interexchange carriers, because of the resulting diseconomic demand/cost characteristics of such charges.

4. The legislation should specify that a Federal-State Joint Board is responsible for designating points of interconnection between interexchange and intraexchange facilities, since that designation is critical to the interpretation of costs to be included in the access charge/contribution mechanism. Because of changing technology, to include a precise designation in the legislation itself would be virtually impossible.

5. Interexchange and intraexchange carriers must be free to enter into agreements to facilitate customer billings and to provide for intercarrier settlements of costs and division of customer charges for services provided jointly by the carriers.

6. Parameters must be established to define the cost components of intraexchange services for exchange ratemaking purposes.

THE "FULL SEPARATION" REQUIREMENT

GTE has concerns with S. 611's provision for "full separation." See: Sections 103(11); 203(b); 205(d). According to Senator Hollings,¹ the separate-entity requirement is the "center-piece" of the proposed legislation.

In this connection, GTE directs the attention of Congress to the "Separate Statement" of Commissioner Joseph R. Fogarty issued in connection with the Federal Communications Commission's Tentative Decision and Further Notice of Inquiry and Rulemaking in its Docket 20828, known as "Computer Inquiry II."² As Commissioner Fogarty points out, various separate subsidiary requirements have been imposed by the FCC in the past "without subjecting the separate-subsidiary concept to any form of critical analysis and without any careful consideration of alternative means of accomplishing our policy objectives."

Commissioner Fogarty stated his belief that the FCC "should examine into the efficacy of requiring separate subsidiaries, and if we decide to do so, the extent to which we should restrict those subsidiaries from contributing to and participating in the corporate vertical integration structure." He indicated special concern that, before the Commission imposes any kind of across-the-board separate-corporation requirement in Computer Inquiry II, it "should question through careful analysis whether the productive efficiencies derived from vertical integration compensate for any detriment to competitor or customer from the possibility of cross-subsidization." In making this recommendation, he pointed out that the FCC has "never assessed the critical cost/benefit trade-offs inherent in these various degrees of separation,

¹ Remarks before the Association of Data Processing Service Organizations, Inc., on May 16, 1979.

² See FCC News Release dated May 25, 1979.

nor . . . examined the question of whether the economies which may flow to the ratepayer from vertical integration outweigh potential abuses."

These same basic questions arise concerning the full-separation requirement of S. 611. An across-the-board requirement would be established by S. 611, calling for the creation of numerous wholly-separated corporate and operational entities. Once again, this requirement would be created at the behest of firms competitive with telephone companies and without analysis of the "cost/benefit trade-offs" or the ultimate consequences for the consumer.

The testimony and material submitted to Congress in connection with S. 611 do not contain the kind of "critical analysis" Commissioner Fogarty has found lacking in FCC consideration of these matters. In other words, S. 611 appears to proceed on an *assumption*, with no factual support, that the interest of the consumer would be promoted by the cost/benefit relationship of a full-separation requirement, as opposed to other mechanisms for protecting the public interest (as one example, improved accounting systems).

GTE is troubled by the proposals before Congress which would impose this kind of across-the-board full-separation requirement based on nothing more than assumptions. Such action would be even more unfortunate than the adoption by the FCC of those administrative rules which Commissioner Fogarty has questioned, since the requirement would be cast in the concrete of a statute.

There is another aspect of this full/separation requirement which should raise serious questions. The imposition of full separation, in practical terms, is likely to prove tantamount to preclusion of telephone company involvement in competitive services. Indeed, just such a preclusion has been demanded by parties competing with telephone companies.

Even if it were concluded, after careful cost/benefit analysis, that it would be feasible and desirable to apply full-separation requirements to some or all Bell companies, it simply does not follow that the same scheme could be applied to the smaller non-Bell companies operating in areas of more dispersed population.

GTE takes no comfort from those provisions of S. 611 that would allow modification of its full-separation requirement in limited circumstances. See: Sections 203(b) and 205(d)(3). The Bill would place the burden on the firm or firms involved to overcome an established across-the-board requirement. This means carrying the weight of demonstration and persuasion in order to produce an affirmative decision, either at the state or federal level, departing from the thrust of the Bill. Any legislation which has this effect cannot fairly be characterized as a deregulatory measure.

If there is to be any provision for full separation in the Act, the statute should place the burden upon the governmental agency to find, based on a factual record and after full opportunity for hearing, that such a requirement is necessary, in the public interest. In other words, when an agency of government proposes to set out a requirement which forces the restructuring of an industry, the burden should be on that agency to show that such a requirement must be applied in the public interest, there being no other less cost-effective remedy.

The question of the kind of separation requirement which would be in the public interest has been addressed by Henry Geller, the Assistant Secretary for Communications and Information, Department of Commerce, in his letter dated May 29, 1979, to Chairman Ferris of the FCC. Mr. Geller indicated the concern of the National Telecommunications and Information Administration (NTIA) with the separation requirements which the FCC attached to its grant of authority for General Telephone & Electronics Corporation to acquire Telenet Corporation and its carrier subsidiary, Telenet Communications Corporation.

Mr. Geller urged the Commission "to consider receptively some easing of the conditions along the lines proposed by GT&E." Mr. Geller suggested that "in its desire to assure a pro-competitive outcome, the Commission may have impeded the acquisition to a point where the ultimate goal sought by the Commission would be lost." While recognizing "that some lines must be drawn and some limitations imposed," Mr. Geller indicated his belief that the public interest would be best served if Telenet were to become a stronger and more resourceful competitor in the value-added market—an objective Mr. Geller saw impeded by the kind of separation requirements the Commission attached to its authorization.

Mr. Geller's letter indicated that NTIA has in progress extensive studies of corporate structure, with specific reference to subsidiary/parent relationships. NTIA urged the Commission to proceed cautiously in view of the "profound consequences for the development of an appropriate regulatory climate in the emerging competitive era." It is even more essential for Congress to proceed in this area only after careful examination of these consequences.

Senator Hollings, in his speech before ADAPSO, indicated that S. 611 would allow fully-separated subsidiaries to "jointly use facilities through explicit nondiscriminatory leasing arrangements." Accordingly, the Senator described the full-separation requirement as "financially workable," and said it would not affect the technical functioning of the telephone system.

It is encouraging that Senator Hollings' intent is to allow this kind of flexibility for telephone operations. However, we can find no provision for such flexibility in the Bill itself. If the intent is to allow for flexibility in sharing facilities, with all the associated operational and administrative costs, then this should be clearly expressed.³

TERMINAL EQUIPMENT DEREGULATION

Except for state regulation of terminal equipment offerings by telephone companies, this market is effectively deregulated today. GTE's position is that this process of deregulation should be completed.

Telephone companies should be allowed to offer terminal equipment and related services on an unregulated basis through their existing operations, subject only to appropriate cost accounting and allocation procedures. Revenues and costs associated with a telephone company's provision of terminal equipment and related service should be accounted for separately and should not be considered in the determination of reasonable rates for those services still subject to regulation.

Each of the bills, S. 611, S. 622, and H.R. 3333, talks in general terms of "deregulating" terminal equipment. This approach is inadequate for such a complex subject. Mechanisms must be established to permit capital recovery of the existing telephone company investments. Such mechanisms would include provisions which would permit telephone companies to accelerate existing depreciation schedules and to recover such accelerated depreciation in the established rate schedules.

Furthermore, if telephone companies are to compete effectively in the terminal equipment area, there must be provisions that assure the right of telephone companies to provide terminal equipment by either lease or direct sale, without the need for establishing separate entities.

In order to proceed with reasonable speed to accomplish deregulation of terminal equipment and yet not cause too drastic a dislocation for telephone company customers, the following is proposed by GTE:

1. As of a given date, all telephone company then-current investments in terminal equipment should be identified and valued at amounts contained in their books and records.

2. As of that date and thereafter, all new terminal equipment and their related costs and revenues should be segregated into a separate account.

The purpose of identifying and valuing then-current investments is to allow a process of attrition of old investments under regulation while assuring that new investments are removed from regulation.

The identified value of old investments can be amortized over a transition period, for example, five to seven years. During the transition period an allocated portion of old investments would continue to be included with costs used to determine interexchange contributions to intraexchange facilities, on a declining basis (due to attrition), until the end of the amortization period.

To minimize dislocation of revenue sources, the objective of the telephone companies and the regulators would be to maximize contributions from old terminal equipment over the amortization period. At the end of the transition process, no terminal equipment would remain under regulation.

All telephone company investments in, expenses relating to, and revenues from new terminal equipment would be separately categorized and would not be subject to either state or federal regulation, except for registration requirements that apply to all terminal equipment provided by any supplier.

INTERNATIONAL TELECOMMUNICATIONS

It has become increasingly apparent that the existing statutory provisions dealing with international telecommunications need revision. GTE's experience with the present governmental approval process concerning international facilities demonstrates the need to streamline FCC decision-making. In particular, GTE supports the need for improvements with respect to facility planning.

In GTE's experience as a participant in international facility planning, the United States carriers and their foreign counterparts have been able to agree on acceptable plans and arrangements through negotiation and compromise, with the help of long-

³ See: Statement of Assistant Secretary Geller before the Senate Subcommittee, dated Apr. 24, 1979, pages 39-43.

standing relationships established between the carriers and their foreign partners over the years.

The principal problem in recent years has been the inability of the U.S. carriers to construct and activate international facilities, because of the FCC's reluctance to grant timely authorizations. The effects of FCC practices extend even to acquisitions of circuits that were constructed solely by foreign countries.

GTE has serious concerns about the international provisions of S. 611, as discussed below. There are some concerns with S. 622, but it does not contemplate the extraordinary results of S. 611. In many ways, GTE's views parallel the international telecommunications views of H.R. 3333.

S. 611 is being offered as a pro-competitive measure, but in the international area it would, for all practical purposes, obliterate any effective private-sector role in the creation and operation of international facilities. It would transfer planning and operational responsibilities, with regard to facilities, from the private sector to the International Facilities Management Corporation.

The associated requirement that the carriers turn over ownership of their facilities to a consortium creates the same kind of concerns. The present ownership arrangements, with improvements in the regulatory process, would, in the long run, be of more benefit to the public.

The International Facilities Management Corporation created by S. 611 to plan, construct, manage and operate international facilities will also create significant additional operating expense. What is being proposed is a very large operating entity in the international area, embracing part of AT&T Long Lines, COMSAT and the Record Carriers, as well as, among others, the international elements of Hawaiian Telephone Company, a GTE subsidiary. The expenses of the corporation would go far beyond the "operating costs" of the facilities—as that term is generally used. There would be substantial overhead costs which go with the creation of this kind of "super corporation"—officers, staff, employee benefits and pensions, for example. Since S. 611 allocates all these costs among the carriers, the public will ultimately be required to bear these costs through higher international rates.

S. 611 would greatly increase the cost of international telecommunications for all carriers and would be totally unworkable for the smaller carriers such as Hawaiian Telephone. This is because of the serious impact the full separation requirements of Section 252 would have on a company the size of Hawaiian Telephone. This section requires full separation between the provider of domestic and international services and also between the provider of non-competitive international public message telephone service, as opposed to the provider of other international services. These provisions, together with those of Section 205, could require Hawaiian Telephone to create four or possibly five fully separated entities to handle its activities in Hawaii.

By not adopting the consortium approach of S. 611, S. 622 reflects a constructive attempt to improve the climate of international telecommunications. GTE does question, however, the effectiveness of the procedure proposed in Section 226(c) of S. 622, whereby the FCC would be even more heavily involved in facility planning matters than it is today.

GTE believes that improvements in the international planning and approval process can be accomplished in a way that would eliminate the expense of a new organization and result in less disruption of joint planning and negotiations with foreign administrations. This would be through the establishment of a task force comprised of all U.S. international carriers, including COMSAT, to plan both cable and satellite facilities. This is similar to the approach proposed in H.R. 3333. Construction and operation of facilities, planned by the task force and agreed to by the carriers' foreign partners, would not require prior approval by the FCC; rather, the FCC would assume an oversight role.

This arrangement, if properly implemented, would tend to reduce the extensive delays currently being experienced by the U.S. carriers. GTE believes this to be a more practical way to solve the facility planning problem without incurring substantial additional costs.

BROADBAND/CATV SERVICES

The public interest dictates that telephone companies as well as others must be able to use all available technologies, of whatever bandwidth, in providing telecommunications. As the switched public telephone network evolves from analog to digital and with the introduction of distributed switching, a broad-bandwidth local distribution medium will be required.

It is expected that fiber optics transmission systems will in time be used to interconnect these distributed switches and multiplexers, in addition to the use of fiber optics on trunk routes between central offices. When the cost of fiber drops to an economical level, wiring the home with optics cable will become feasible. At such

point, it will be possible to carry efficiently digital information even at the bit (binary digit) rates required for video.

Indeed, voice, data, and video signals will then be only different manifestations of the same thing—information represented by bits. It would be counterproductive to restrict telephone companies from utilizing these new technologies, particularly since they present opportunities for making new telecommunications services available on a cost-effective basis.

In assuring a climate in which telephone companies can use all technologies, the Act should at the same time be flexible enough to permit a variety of responses by telephone companies to meet local customer needs.

GTE does not want to be prohibited, either by the Communications Act or by FCC/CRC rules, from being able to offer broadband services. Offering such services might well permit the public and GTE to gain maximum advantage of the economies of scale which could develop from broadband technology. The forced disassociation of the transmission of broadband/CATV services and narrowband services could delay the point in time when the telecommunications user could enjoy the benefits of fiber optics technology.

Companies like GTE should not be prohibited from examining and implementing alternative methods of accelerating the introduction of fiber optics technology for the benefit of the telecommunications user. This option must be kept open, in order to allow GTE telephone companies to develop and plan for the enhancement of the local exchange network.

Recently the FCC has started to re-visit its CATV cross-ownership rules, as they relate to sparsely populated areas. Rural areas in most cases do not have CATV service. Their low density of homes makes the provision of CATV service unattractive to CATV companies. Evolving technology might make rural CATV service more economically feasible if a common facility could be used to provide both narrowband and broadband telecommunications services. GTE believes that telephone companies could play an important role in extending broadband/CATV services to areas of the country which otherwise would not be reached. But with the present uncertainties in Congress and with the barriers presented by FCC rules, GTE telephone companies are not presently pursuing CATV in their rural areas.

SPECTRUM MATTERS

GTE has concerns as to the use of "scarcity" or "market value" concepts when applied to the assignment of common carrier nonbroadcast frequencies. The FCC currently has a proceeding underway (Docket 78-316) to explore the ways by which future fees should be set. A major issue raised in that docket is the "market value" concept. In comments filed with the FCC on February 9, 1979, GTE addressed the application of the concept to common carrier frequencies.

In brief, GTE believes that charging spectrum resource or scarcity fees for use of electromagnetic frequency spectrum by common carriers is not in the public interest. The public, and not the carrier, is the true beneficiary of the services of the Commission in processing applications and in the use of spectrum for the provision of common carrier services.

GTE also questions the concept in H.R. 3333 of a random selection method for assigning nonbroadcast frequencies when there are competing applicants. For common carrier applications, at least, the public interest should be the determining factor, not a system based on random selection. There could be service impairment if carriers are blocked from expanding their nonbroadcast radio services simply because they did not win a lottery drawing. The determination as to the preferred applicant, where more than one qualified applicant seeks the same frequency, should take into account the importance of the service to be provided to the public.

Any legislation should endeavor to reduce the administrative burdens associated with licensing procedures. For example, H.R. 3333 proposes a one-step licensing procedure instead of the current two-step construction permit/license process. See: Sections 412 and 415. The present Act's provisions allowing petitions to deny applications should, however, be retained at least to the extent that frequency interference problems would result from grant of an application. Only through such a process can disputes regarding potential interference be resolved on a timely basis.

BIFURCATION: CREATION OF A SEPARATE FEDERAL TELECOMMUNICATIONS COMMISSION

At the present time the FCC, in GTE's view, is not able to do justice either to broadcasting or to telecommunications. As a result, neither area receives the attention it deserves. GTE has been recommending for some time that there should be two separate federal regulatory agencies, one focusing on broadcasting and the other concentrating on telecommunications matters. "Technological convergence"

notwithstanding, there are distinctive differences, deserving distinctive regulatory oversight, between the essentially private, First Amendment-protected activities of broadcasters and the public obligations of telecommunication common carriers.

H.R. 3333 contemplates the establishment of a five-person Communications Regulatory Commission, or CRC, to replace the present Federal Communications Commission. GTE suggests that the CRC concept be adapted to fit the need for a separate Federal Telecommunications Regulatory Agency. Establishing such an agency would mean that the present Act's assignments would have to be divided between the new CRC and the broadcasting agency. Those broadcasting responsibilities now assigned by the Act to the FCC would need to be assigned to the broadcasting agency.

The foregoing comments are submitted by GTE to assist Congress in its consideration of the Communications Act and appropriate amendments thereto.

Senator HOLLINGS. Thank you very much, Mr. Brophy.

Now, Mr. Hostetler.

Mr. HOSTETLER. Thank you. I am here on behalf of Western Union Telegraph Co. this morning. We thank you for the opportunity to appear. Let me just say a word about Western Union as it operates today for those not fully familiar with us.

We provide services, basically, in three broad categories. Public message service to the public at large on a nonsubscription, unequipped basis, which includes telegrams, Mailgram service, money order service, and teletypewriter exchange service, including TWX and Telex.

Finally, private line service to government and business users with large enough requirements to justify their own dedicated systems.

We don't provide voice telephone service, and we don't provide any direct international service except by interconnection with the international carriers.

We provide these services over facilities on which we spent more than a billion dollars in the last 15 years. These include a nationwide microwave system, the first U.S. domestic satellite system, which became operational in 1974, several high-capacity computer switching systems, much like those used by the telephone companies, central telephone bureaus which provide access to our public message services, and we also are heavily dependent at the present time on the Bell System and some of the other telephone carriers for leased facilities.

In looking at my prepared statement last night, which we filed, I discovered it didn't say, in several respects, what I wanted to say.

Senator GOLDWATER. Pardon me, is Mailgram your service?

Mr. HOSTETLER. It is a service we provide jointly with the Postal Service, yes, sir. As I said, I was having trouble last night with my statement, so I prepared some notes and will try to speak extemporaneously from them, if I may.

First, with regard to our position on S. 611 and S. 622, we support the goals expressed in those bills. Particularly, we are in favor of increased competition. I would say one concern we have with both bills is that they appear to place great reliance on the present regulatory mechanism under the 1934 act.

The assumption seems to be if this mechanism is shored up or improved in some respects, it can be made to work better, and perhaps even enhance the competitive marketplace.

In this connection, we believe that both bills probably leave too much to the discretionary authority of the Commission. In my

view, there are two things wrong with this assumption, if I understand it correctly.

First, it flies in the face of the old axiom that competition and regulation are antithetical concepts in the long run.

Second, quite apart from theory, as Mr. Geller testified here at length, the regulatory system really has not worked that well in the developing competitive marketplace of telecommunications.

Let me say our experience at Western Union is based on competing with the Bell System for many years, long before there were specialized carriers and long before it became fashionable to talk about competition in this industry.

I think we at least bear the scars, and hopefully have learned something about the realities of competition. The fact is that after 20 years of investigations, rulemakings and prescriptions, the FCC has not been able to effectively regulate Bell's pricing response to increased competition.

The result is that Bell used its monopoly power over facilities built initially to provide basic voice telephone service to dominate competition in the nontelephone market.

Mr. Geller gave some examples of the regulatory process in action. He referred to the Telepak proceeding before the Commission beginning sometime in 1963, finally terminating, hopefully, last year. He didn't mention reconsideration of its final decision. The Commission in that action reversed itself on the basis that, in its view, it had not given proper notice to the parties, during that 17-year period, of the issues which were being litigated.

Now, how can we deal with this problem? It seems to me—I am talking about the problem of regulating Bell's monopoly power only in one of two ways.

Either we keep Bell out of the competitive marketplace, and there are few of us advocating that, or we have to find some way to remove the incentive to Bell's cross-subsidization. In my view that can only be accomplished by completely separating the competitive and noncompetitive markets. Let me say I am not talking here about the five subsidiaries Mr. Brophy mentioned. I am more concerned about the distinction between the voice telephone market and the other telecommunications markets.

I see that largely—the other markets as largely a single market. I think to accomplish this, this means separate subsidiaries for Bell's competitive services.

I would say that this is the single most important feature of S. 611 and it must be retained. Without it, all of the regulatory features in that bill or that one might otherwise opt for, won't work, in our judgment.

With it, some of the regulatory requirements in the bill probably are not necessary. There has been a lot of talk, both before this subcommittee and over in the House, about the inadequate accounting procedures which the FCC has employed for years and the need for greater visibility on the costs. I am not going to argue some changes might not be warranted in those procedures. Probably long overdue. But in my judgment, this isn't really the issue.

The problem isn't the lack of data or visibility on costs. I am sure the Bell System knows what its costs are and I am sure the FCC or

anybody else who poured through those volumes of support data the Bell System filed, has a pretty good idea what the costs are.

The problem comes after you have the data, and that is what to do about it. This involves philosophy, judgment, and under current FCC rules, it requires forecasting. These are areas that are very subjective and here is where the controversy is.

I was thinking about it this morning, and it occurred to me if you took a set of stipulated costs which everybody could agree on, and put them in the same room with people with diverse philosophies, like Harold Geneen, Ralph Nader, Arthur Fiedler, and the chief accountant of the FCC, you probably would have a diverse reaction as to what the data show and what to do about it.

Without meaning to be disparaging, this is largely what we have in the process over at the FCC. We have different points of view represented as to what should be done with the data that is available.

The Bell System, of course, is very cognizant of this problem, and they have exploited it. Ten or 12 years ago, the Bell System filed costs on seven different bases—not a lack of data; the problem really is too much data.

Last December the Bell System filed 17 volumes of cost data in support of new rate filings. After several years of arduous effort, the FCC Common Carrier Bureau in negotiations finally agreed with the Bell System on a new cost methodology manual to be used for future ratemaking.

The first time that manual was used, the administrative law judge threw it out as not meeting the requirements of the case.

The problem isn't the lack of data. We have plenty of data. While that can improved, the real issue is how to make decisions based on that data. This is the problem confronting the FCC for the last 20 years.

The same thing could be said about the problem of faster administrative hearings. The bill approaches that by requiring that decisions be made within a certain time. It is true the FCC has not in the past been very fast in its decisionmaking process, but again, this isn't the problem.

I am confident FCC can make decisions. The problem may be that those decisions are bifurcated, to deal with a single simple issue without reaching the policy problems that are inherent in the entire procedure.

Moving on very quickly, let me say that another problem we think is inherent in the bill is too much discretion. It left to the FCC to determine who should be category I and II carriers. I would suggest in the circumstances of the present marketplace, only the telephone carriers are category II carriers, and the bill should make this clear.

While the FCC should be given the discretion to make a contrary determination, the burden of proof should be on them to demonstrate, after the opportunity for a full evidentiary hearing, that a different treatment is warranted.

I am very much encouraged by the appearance of the term "generic" in the bill. When one talks about the classification of the marketplace, it is important.

Again, looking at Western Union's services, we believe our Telex service, for example, is competitive with a number of services being provided. Telex is in no way a category II service, even though we are the only carrier providing a service by that name.

I would welcome the opportunity to amplify further.

Thank you.

[The statement follows:]

STATEMENT OF RICHARD C. HOSTETLER, WESTERN UNION TELEGRAPH CO.

My name is Richard Hostetler. I am Vice President and General Counsel of Western Union.

Some members of the Subcommittee may not be familiar with Western Union's current communications activities, so I would like to take a moment to provide you with a brief description of our Company.

Western Union utilizes its terrestrial and satellite telecommunications plant to provide a full range of telecommunications services. These services may be classified into three broad categories:

1. Teletypewriter Exchange Network Services—providing for dial-up teletypewriter-to-teletypewriter exchange of record message communications. These are our Telex and TWX services.

2. Leased Private Line Services—providing customized transmission channels and equipment for business and government users having telecommunications requirements large enough to justify dedicated systems.

3. Public Message Record Services—providing services to the public at large and to business users, largely on an unequipped, nonsubscriber basis. Included in this category are public telegram service, Mailgram service (provided jointly with the Postal Service), and public money order service.

We do not provide any basic public telephone services, nor do we manufacture any telecommunications equipment or provide any direct international telecommunications services. Section 222 of the present Communications Act prohibits Western Union from extending its record services overseas except by means of interconnection with the international record carrier cartel. I plan to cover this matter with the Committee subsequently when it considers the international aspects of the proposed legislation. I would note at this time that Western Union believes the international and domestic telecommunications requirements of users to represent a single integrated market and that any carrier that is denied the opportunity to provide both international and domestic services, as is Western Union, is placed in a tremendously unfair position in competing in this integrated market. Fighting with one hand behind your back is difficult, at best.

In terms of resources and financial power, Western Union is a small company as compared to the giants of our industry—the Bell System, IBM, ITT, RCA, and Xerox—with whom it must compete. Western Union's annual revenues of about \$700 million are less than two percent of the Bell System's revenues of over \$40 billion.

Despite our resource limitations, we have tried our best to compete. We have developed a substantial terrestrial transmission system, including a nationwide radio beam microwave network; supplemented that transmission capacity with the first domestic satellite telecommunications system; integrated our various record service networks through high capacity computer switches; enhanced the availability of our record message services to the general public through large centralized telephone answering centers; and developed a number of new, previously unavailable, telecommunications services—such as Mailgram—designed to meet unique requirements of the telecommunications market.

Western Union's ability to compete in the domestic arena and to earn a fair return on its major investments in telecommunications facilities has been limited in two major respects. The first relates to the failure of the F.C.C., despite a major effort, to prevent the Bell System from engaging in the underpricing of services to the larger business and governmental users. These pricing practices have permitted the Bell System to expand its monopoly into the non-basic telephone markets, the only markets where true competition has been feasible, leaving competitors to fight over the remains of those markets. The second limitation on our ability to become a viable competitor stems from the Commission's unfounded concern that Western Union might somehow gain an advantage over other non-Bell System carriers and its consequent application to Western Union of regulatory constraints that have not been applied to these other carriers.

With this history, you will not find it surprising that Western Union totally endorses deregulation and the substitution of competition in the marketplace as the far superior means of attaining low rates, quality service, and the benefits of technological development. Regulation should be tolerated only where competition and rigorous enforcement of the antitrust laws cannot reasonably be expected to control monopoly power. This premise underlies both S. 611 and S. 622.

The recognition of the frailties of regulation and the absolute need for greater visibility of Bell System activities is manifested in S. 611. We strongly endorse the view that the "fully separated entity" concept as a deregulatory tool will substantially eliminate the Bell System's capability to cross-subsidize the underpricing of competitive services from monopoly revenues, to overprice monopoly facilities required by others to compete, and to continue its total dominance of the telecommunications market. The trail left by Bell at the F.C.C. is one littered with examples of the failure of attempts at regulation through traditional cost allocation and accounting methodologies—Telpak, WADS, WATS, CCSA, SCAN, and more recently, Series 7000 Video, DDS, and MPL. These are the offerings that have enabled Bell to monopolize the non-basic telephone telecommunications market. Most are not functionally distinct services, but rather are pricing schemes benefiting larger business and governmental users at the expense of small users.

We do not believe that the separation of Bell activities as proposed by S. 611 need result in any loss in efficiency, as claimed by Bell. This is nothing more than the same old claim that monopoly is economically more efficient than competition. It must be remembered that Bell develops better than 90 percent of its \$40 billion in revenues from basic telephone services and there is nothing in the separated entity proposal of S. 611 that should have any adverse impact on the efficient provision of those services.

Our concerns with S. 611 are important, but limited. It is clear that only the Bell System has the monopoly resources to thwart the development of a truly competitive industry. Certainly, Western Union has no such power. Our services are provided in direct competition with Bell whose "dataphone" service offering enables ordinary telephone subscribers (and WATS subscribers) to use the basic telephone network to transmit hard copy messages by means of teletypewriter, facsimile, and other terminal devices. In addition, new common carrier entrants like Graphnet, Telenet, and Tymnet are providing record telecommunications services that also compete directly with our services. Similarly, non-regulated data processors are providing ancillary communications services that compete for record message traffic.

We strongly urge that Section 204 of S. 611 be clarified so that only the Bell System will be classified a Category II carrier and that all other carriers initially will be in Category I. We agree that reclassification by the Commission should be possible only after opportunity for hearing. A principal criterion in any such determination should be the power to control prices, as proposed in H.R. 3333. The approach in S. 611 would pose the substantial difficulty of defining appropriate markets and would ignore the more meaningful test of price elasticity.

While S. 611 draws the proper boundary between Federal and State jurisdiction over telecommunications services, we are concerned that the intent of the bill may be misconstrued. Certainly regulation of telephone exchange service is a matter properly left to the state commissions. We do believe, however, that S. 611 should make clear, as does S. 622, that state regulatory control is confined to exchange telephone service. Non-telephone services which involve a minimal amount of incidental local exchange services should not be subject to the unnecessary burden of regulation in each of the fifty states. As an example, Western Union's TWX service produces total annual revenues of \$112 million. Only 13 percent of those revenues develop from intrastate service and only a small portion of the intrastate revenues is attributable to local exchange traffic. To burden carriers and state commissions with regulation of such minor activities would be costly to consumers and counterproductive.

The other major concern we have with S. 611 relates to the provisions of Section 222 which deal with the Basic Exchange Maintenance Program. The bill appears to contemplate the collection of fees from all interexchange carriers whether or not they use exchange switching facilities of the local telephone carriers and whether or not they offer services which are direct substitutes for basic telephone service. Such fees are really taxes which may well increase the cost and retard the growth of record and data services. Looking at history, we can ask whether telegraph service users should have paid a fee to maintain Pony Express. Indeed, should early telephone service users have subsidized the availability of telegraph service. We urge that at most any collection of fees (as opposed to the recovery of costs) should be limited to those services which are direct substitutes for basic telephone service.

Finally, we are concerned with the provisions in S. 611 which pertain to spectrum fees, insofar as those provisions would apply to common carriers. S. 622, which limits fees to the Commission's costs, is, in our view, a sounder approach.

This concludes the general observations I have to offer on the domestic aspects on S. 611 and S. 622. Thank you for your time and attention and we commend you for your leadership and your thoughtful and workable proposed revisions to the Communications Act of 1934.

Senator HOLLINGS. Thank you.

Mr. Bunke.

Mr. BUNKE. Mr. Chairman, Mr. Goldwater and members of the subcommittee: I am Robert W. Bunke, president, chief executive officer, and a director of Cencom, Inc., a Minnesota-based telephone holding company, which serves approximately 26,000 telephones through subsidiaries in Wisconsin and Alaska. I am also executive vice president of Ace Telephone Association, headquartered at Houston, Minn., which serves about 16,000 telephones in Minnesota and Iowa.

It is also my privilege to serve this year as the president of the United States Independent Telephone Association which represents over 1,500 independent telephone companies which are neither a part of nor controlled by A.T. & T.

I do have a longer statement which I will now summarize, but I request that the full statement be placed in the record.

It is not my intention to discuss all portions of S. 611 and S. 622.

In these few minutes, I want to highlight three things: First, the bills contain certain ambiguities as we see them; second, they try to provide universal telephone service and competition without first balancing the priorities for best serving the public; and third, the difference between an integrated network and one that is merely interconnected does not appear to be recognized.

There are many sections in these bills which are lacking clear definition of their intent. Even my formal statement has not covered all of them. But the few I mention indicate a need to insure the bill is specific, the objectives understandable, and that the results will not risk dismantling an industry and a system which works well without a reasonable certainty its replacement will be an improvement.

I trust the subcommittee will retain an open mind, will respond to questions raised throughout these hearings, and will consider specific telephone industry recommendations which may be submitted during the hearings or later for the record.

I am not certain that the planning program in part III of title II of S. 611 will enhance an already outstanding REA telephone program. I do fear it will bring the current program to a halt for an extended period while reorganization takes place.

I also believe that if the program is adopted, the planning should be on the State and local level where local needs are understood and with an absolute minimum of Federal involvement. Really, we don't need so much help in planning, other than let us go ahead and do the planning.

It also appears the bill goes much too far in protecting against cross subsidies between noncompetitive services and services in the competitive arena. The wholly separate entity concept really requires a carrier desiring to compete to create a wholly separate company, not just a subsidiary. The principal company can own the

separate company, but any attempt to influence the separate company's policies would seem to violate the spirit of the statutory language demanding the highest degree of separation.

The requirements appear unrealistic. Adequate accounting procedures should be sufficient in most cases, and among smaller telephone companies, especially, even accounting procedures should be extremely simplified because competitive markets will be limited, and the risk of cross subsidy minimal.

I hope the subcommittee has carefully considered the removal of the term "common carrier," replacing it with category II carrier. There is a long line of legal precedent involving common carriers which may be lost and some side effects which are unknown. I have no idea from the language of this statute whether a category II carrier could acquire rights of way under the principle of eminent domain, something that has been very important to us throughout the years.

I know the sponsors intend to permit the small telephone companies to be regulated differently from the larger ones, but we find few specific guidelines regarding the FCC's authority to classify carriers at different levels or the authority of the State commissions or the FCC to waive the separate entity requirements. We are looking for more specific guidelines.

I also have questions with regard to jurisdiction over terminal equipment or other telecommunications and electronic equipment. The language of the bill seems to make commerce in telecommunications equipment competitive but then retains FCC regulatory control over it if marketed in interexchange commerce. This is a coined phrase, not defined in the bill, and probably new to the legal field.

Under section 205, the bill grants extensive discretion to the FCC to do what it deems is necessary to carry out the purposes of the bill. Indeed, several parts of the bill seem to place the Commission in a position to manage telecommunications carriers rather than regulate them.

One such provision would have a permanent joint board administer the basic exchange maintenance program. A joint board does not seem suitable for that purpose since it is not an administrative agency. I see no need for any government agency, and particularly our regulators, to manage any of the revenues of our industry. They should provide oversight to any such program, but our industry is capable of administering its own funds.

I believe this subcommittee should recognize that the integrated switched telephone network is the reason we enjoy the highest quality telephone service in this country and the reason subscribers we serve can reach any other subscriber anyplace in this country.

That network is jointly provided, planned, and managed so that all of the providers meet their obligations and make their business decisions to benefit the entire network rather than strictly for their own local company interests. Every telephone company, independent and Bell alike, plays an important role in completing the total network. We are all part of it.

Further, the competitors who have entered the telecommunications market and who provide like services have not become a part

of that network even when fully interconnected. They serve selected routes and selected subscribers. Their services are not open to all comers. They do not replace the need for a network to serve everyone. These other carriers are not integrated into the network, they are only interconnected. The integrated network permits the entire network to be used as needed to serve all. Routing of communications traffic can be made over any part of the network as the need requires, without concern for who owns or controls what piece. But the facilities the other carriers own are not available to ordinary telephone subscribers or for use by the telephone industry for routing ordinary telephone traffic. There have been many attempts to draw a parallel or comparison of other business to our telephone business. Although it is difficult to find a similarity, I think our system of highways, roads, and streets may be somewhat the same. It, too, is provided on an integrated basis by separate entities. The cities, counties, States, and Federal Government.

The system permits anyone in our country to travel from anywhere to anywhere. If one road is closed, another route is available. It does not matter what travels over the roadway. It could be pedestrians, bicyclists, automobiles, trucks, buses, and so forth. The roadway network is there. It is the backbone transportation facility available for all the public to use.

There are other alternatives to be sure. There are railroads and waterways and airlines. Each of these provide a type of transportation from one place to another, but not from everywhere to everywhere. None could exist efficiently without the Nation's roadways. Airports can close or railroads can strike, and people continue to travel. There may be inconveniences to be sure, but commerce continues to function. However, if the roads, highways, and streets are closed, everything stops. You have experienced that fact in Washington, D.C., during demonstrations blocking traffic arteries. This past winter during a massive snowstorm, the city came literally to a standstill. The airlines and the railroads serve specialized needs. They, too, depend upon the road network for their survival.

Likewise, the other common carriers depend upon the national public switched telephone network for their success. We provide them with a capability they must have to offer their alternative to the telephone service we also provide to the public.

I believe that if this subcommittee is intent upon preserving the concept of universal service at reasonable rates, it must specifically address and provide for the continued joint provision by telephone companies of an integrated switched telephone network. It must permit the companies to jointly plan, build, own, operate, and manage a nationwide telephone service network. It must insure that the companies engaged in that joint venture can receive a fair financial return for their joint investment and effort.

I am not convinced that the average subscriber will benefit from unrestrained competition, but I understand that competition is here. Our industry is willing to help design a policy to preserve for this Nation the benefits of an integrated telephone network, while also permitting competition.

But care must be taken now to insure the result does not fragment the network or impede our industry's approach to network planning and management. If there is no network—if each carrier

subordinates its decisions to the narrow interests of that company, without concern for the needs of the Nation as a whole—then universal service at reasonable rates may be a thing of the past.

I urge this subcommittee to place great emphasis on the priorities of national policy. Insure that our Nation as a whole is served, which I believe requires the preservation of the telephone service network. Keep that network healthy, for it is the heart of our telephone system. Destroy the network, and telecommunications may be available to the few but not the many.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT W. BUNKE, PRESIDENT AND CHIEF EXECUTIVE OFFICER,
CENCOM, INC.

Mr. Chairman and members of the Subcommittee, I am Robert W. Bunke, President, Chief Executive Officer, and a Director of Cencom, Inc., a Minnesota-based telephone holding company which serves approximately 26,000 telephones through subsidiaries in Wisconsin and Alaska. I am also Executive Vice President of Ace Telephone Association, headquartered at Houston, Minnesota, which serves about 16,000 telephones in Minnesota and Iowa.

It is also my privilege to serve this year as the President of the United States Independent Telephone Association which represents over 1,500 Independent telephone companies which are neither a part of nor controlled by AT&T.

It was my great, good fortune to enter the telephone industry in 1951 after serving in the U.S. Marine Corps in Korea. I first went to work for Ace Telephone Association and have personally experienced the struggles, problems, and successes of our industry as it has met the tremendous challenges of the past quarter of a century. I am proud to be part of the Independent telephone industry which serves more than 30 million telephones located mostly in the smaller towns and rural areas of the United States.

Our industry has indeed met the challenge of tremendous growth and changing technology in an outstanding manner. The results today are a tribute to the free enterprise system. In 1945 at the end of World War II, our entire country was served by about 28 million telephones. Even then, the United States was a "wired nation" whose telephone communications capability was far superior to the rest of the world. Today, the Independent telephone companies serve more telephones than the entire nation had then; yet we provide service to less than 20 percent of the telephones in this country.

We have helped bring to the rural areas telephone service which equals or exceeds that of the rest of the nation.

That success must be credited to the thousands of telephone people who have dedicated their lives to providing the best possible communications service to their subscribers. Additionally, credit must be given to the Congress which set a goal of universal telephone service with adequate facilities at reasonable rates in the 1934 Communications Act. Moreover, to insure that all the people of the U.S. would enjoy the benefits of adequate telephone service, the Congress amended the REA Act to help provide financing in the rural areas.

Thus, Congress, as a matter of policy, set goals and objectives which the telephone industry has continually endeavored to meet.

Some have said that since we virtually have achieved the goal of universal service, it is possible to direct our efforts elsewhere. But I am convinced that with a growing and shifting population, that goal still should be the primary purpose of Congress in defining a telecommunications policy for the years ahead.

When S. 611 and S. 622 were introduced, it was very gratifying to me to note that the sponsors of this legislation held out, as a prime objective, the need to continue to provide universal service at reasonable rates. At the same time, it was hoped to provide a plan which would bring to the people of this nation the potential benefits of competition and deregulation.

As you, Mr. Chairman and the other members of the Subcommittee, are well aware, our industry has struggled to find a solution to the dilemma those two objectives create. Our industry's economic structure was molded over the years to provide all the companies with adequate revenues to insure all the people of this nation could be served. The economic system was devised during a time when there was no direct competitive substitute for the services our industry provided. But that picture is changed. Our companies, our entire industry, recognize the clock will not

be turned back to a time when each of us was far more comfortable in planning our companies' programs and in judging, on a long-range basis, the tremendous investments we would be required to make to provide the capacity and service required.

Obviously, a competitive world brings us new challenges. It requires our companies alter many of the business judgments they must make as they look to their future role in the telecommunications industry.

Although my personal involvement in this industry is with companies providing only some 42,000 phones, a very small portion of the total in this country, I am convinced that any national policy will have an impact on my companies and their subscribers similar to the impact on every other telephone company and the subscribers they serve.

I am sure this Subcommittee is seeking a policy which will indeed permit all subscribers to continue to enjoy the finest telecommunications service in the world. That should continue to be your objective and ours as well.

I am just a country boy from Minnesota who has been lucky enough to spend his career in a great and good industry serving a great and good nation. I am an eternal optimist who believes that people working together in good faith can find solutions to even the most difficult problems.

It has been encouraging to me as I have worked actively in the Independent telephone industry to observe the many people involved in the telecommunications debate devoting tremendous efforts to finding a satisfactory solution. Certainly, the sponsors of S. 611 and S. 622 and the staffs which worked on these bills deserve our industry's commendation for coming to grips with historically complex problems. I hope these efforts and the dialogue we are having will bring us much closer to a solution than might not have been thought possible even a few months ago.

I know also that neither of these bills was held out to be a final, conclusive blueprint but rather that the sponsors have urged comment and proposals which may constructively lead to amendments and a legislative package meeting the needs of this nation.

Accordingly, I would like to offer some observations which I hope will help in finding final answers. I believe that if any legislation is to receive the broad support of the many interests involved, it must very clearly define its goals and the impact it will have on all the participants in the telecommunications industry and the people they serve. My concerns with both S. 611 and S. 622 stem from the uncertainties they engender. While goals are stated, impacts are unknown. I have questions and find ambiguities which trouble me greatly. I wonder if the goals can be met, and, if pursued in the manner required by the legislation, I wonder at what cost to the subscribers in both rates and quality of their service.

I am convinced the people of the United States should continue to be assured reliable nationwide telephone service at reasonable rates. I also am convinced that assurance cannot be given unless the telephone companies are obligated to provide basic local and basic intercity services. In other words, I believe it is unrealistic to expect a deregulated, competitive telecommunications industry can continue to meet that goal now or even within the lifetimes of most of us here.

Since competition and deregulation are stated objectives, my problem stems from an imbalance in the emphasis placed on competition for competition's sake rather than first insuring that we preserve the good we have. Competition should be encouraged only under conditions which will not threaten the right of every American to enjoy basic telecommunications service. I know that is what each bill intends to accomplish, but we should be very certain of the results before these bills are approved. We should never risk dismantling an industry and a system which works well without reasonable certainty that its replacement will be an improvement.

I trust that as the work continues on this legislation, the Subcommittee will retain an open mind, will examine the questions raised, and will consider specific recommendations. I also trust the Subcommittee will insure that the language and the intent of the legislation will clarify ambiguities I now find in the proposed bills. S. 611, in particular, is complex. It raises questions I believe must be answered officially and on the record; insofar as possible, the language of the legislation should insure there can be no misunderstandings.

I have already mentioned the importance of the REA telephone program to the development of rural telephone services. That program and the people in the Department of Agriculture who have administered it have been outstanding. Accordingly, I am concerned that Part III of Title II may not accomplish what it intends.

That part is directed toward rural telecommunications development and brings a number of new players and government agencies into the process. I have never opposed adequate planning by private business or the government, but I am not impressed with most government planning programs. I therefore wonder whether

the rural telecommunications planning program established under this bill will help or hinder rural telecommunications.

The Chairman is already aware of the Regional Planning Commissions established nearly fifteen years ago. That program is requesting a 1979 budget of almost \$63 million, although most people familiar with it, including President Carter, have suggested the regional commissions are a waste of time and money. Because the Chairman of this subcommittee is also Chairman of another subcommittee considering that budget, I am sure he is anxious to avoid a program in this bill which might be ineffective. From our viewpoint, the telecommunications needs of the rural citizens can best be understood and planned for on a state and local level with an absolute minimum of Federal involvement. Also, the Subcommittee should insure that this part of the proposed legislation, if adopted, would not bring the effective programs of REA to a halt for an extended period of time while all the reorganization and adjustments are made.

As I have indicated, the thrust of the bills is toward encouraging competition and deregulation. That is the scheme outlined and results to be achieved. There is also language which seems to indicate an intent not to just encourage competition but to additionally redistribute the management, ownership, and control of the telecommunications industry. That concept appears in section 101 which says a purpose of the bill is to encourage "diversity of ownership and control of telecommunications media * * *" and it runs throughout the bill in the highly restrictive requirements for a Category II carrier to compete.

It appears to me that a wholly separate entity, by definition, is a separate company rather than a subsidiary. Thus, by the bill's requirements and definitions, many of our companies, as a practical matter, would be required to divest or separate parts of their business. They could maintain only formal ownership. To suggest that ownership is sufficient to allow policy control over those wholly separate entities, is to suggest that a Category II carrier should engage in a subterfuge to get around the statutory language demanding the highest degree of separation.

We believe that a separate subsidiary for competitive purposes should be necessary only in the extreme case where it is impossible otherwise to insure there would be no cross subsidy between the noncompetitive and the competitive endeavors. In most cases, adequate accounting procedures would be sufficient, and among many of the smaller telephone companies, even such accounting procedures should be unnecessary or extremely simplified because the competitive markets would be limited and the risk of cross subsidy minimal. I recognize under S. 611, the state regulators or the FCC in some cases could waive the stringent separation requirements for Category II carriers, but the language allowing this is imprecise, and the authority limited and uncertain.

For instance, on the terminal equipment problem, section 203(b)(3) permits a state commission to modify the full separation requirement under certain circumstances. But the circumstances allowing that to occur are very limited by the strict language of this legislation. The state commission may alter the requirements only for an exchange carrier which in conjunction with any affiliated carrier provides only "public message exchange services." First, there is no definition of "public message exchange services" in the bill. Second, it is doubtful that any telephone company, even the smallest, would provide only "public message exchange services."

Additionally, section 205(d)(3) authorizes the Commission to permit any carrier providing interexchange service solely within a single state to provide exchange service within the state under less than full separation if full separation would impose an unreasonable burden because of the size and nature of the carrier. This carries out the legislative intent to permit an exception for the smaller companies from the stringent requirements the bill would place on the larger Category II carriers. However, the exception is left to the discretion of the Commission with no adequate guidelines. Also, it appears that if the Commission granted this exception, it would preclude the state from granting the exception previously mentioned because the carrier would no longer provide only public message exchange services.

Section 102(a) grants the FCC jurisdiction over all commerce in telecommunications and electronics equipment and services, information software and information services. It is recognized that elsewhere in the bill, these items are essentially deregulated, or at least that appears to be the intent. However, giving jurisdiction over all telecommunications and electronics equipment is very sweeping. Much of that equipment is used privately and its use may have nothing whatsoever to do with communications. My car, for example, contains electronics equipment.

Even the question of deregulation of such equipment is left in doubt. For instance, in section 103, defining "telecommunications" and "telecommunications service", the definition includes "instrumentalities, facilities, apparatus" or "any capability integral to the controlled operations of a telecommunications system * * *". This

seems to cover "equipment." We wonder how much equipment is deregulated and how much is not?

We assume that the equipment under consideration is what is known as terminal equipment, but even that is not clear. Section 203(a) states that the sale of telecommunications equipment (omitting electronics equipment) is not deemed to be telecommunications service and thus seemingly not subject to regulation. However, section 231(a) states that the FCC can prescribe conditions under section 205 regarding the marketing in "interexchange commerce" by any exchange carrier of telecommunications equipment, electronics equipment, and so forth.

Section 205 gives the FCC tremendous authority and almost unlimited discretion to carry out what it deems to be the purposes of the legislation. Thus, jurisdiction which is taken away appears to be returned under at least some conditions involving "interexchange commerce by any exchange carrier." The phrase "interexchange commerce" is coined terminology which is not defined in this Act and may even be new to the legal field.

Section 102(b) limits the scope of the FCC's jurisdiction stating that nothing in the Act be "construed to apply to, or give the Commission jurisdiction with respect to charges, practices, services, facilities, or regulations for or in connection with telecommunications services which do not form a part of an interexchange service." This is not a very clear line of the demarkation. Telephone companies are designed to provide the customer with both local calling and long distance capabilities. Many of the activities and facilities of any company are jointly dedicated to that purpose. Hence, it is difficult, if not impossible, to determine under what circumstances the FCC would or would not have jurisdiction. Surely, the line of demarkation can be defined more clearly.

I am also troubled with the specific intention spelled out in section 105(3) and elsewhere to delete the term "common carrier" and substitute "Category II carrier" in its place. It has been explained to us that a Category II carrier will be treated as a common carrier has been treated in the past. But it appears to us that the change is significant and the results unknown. There is a long line of history in the English common law and under interpretation of statutes, including the 1934 Communications Act relating to "common carriers." Changing the words may change all of the understandings which have evolved in that long line of precedent.

Common carriers have certain duties and obligations and also have been accorded certain rights and privileges. Certainly, the duties and obligations appear to be continued regarding Category II carriers. It is more difficult to find the rights and privileges.

Moreover, the change creates side problems not addressed. Common carriers serving the general public usually can obtain rights of way and easements by condemnation proceedings under the theory of eminent domain. Where does a Category II carrier stand in this respect? Is a Category II carrier the same as a common carrier?

The FCC can classify different levels of Category II carriers. Do all levels have the same standing to acquire rights of way by legal action? In theory, competition will evolve, and there will be few if any Category II carriers. What then will be the rights of the carriers in obtaining property rights to serve all the public?

Does a Category I carrier have any standing similar to a common carrier?

Section 202 imposes upon the Commission an obligation to reduce the exercise of its powers from time to time. S. 611 is a complicated regulatory scheme, and we have little hope that the FCC of its own volition would move toward a less pervasive degree of regulation. That simply is not the history of any bureaucracy that we are aware of.

I previously mentioned that section 205 gave the FCC almost unlimited discretion to do what it "deems" to be necessary to carry out the policies of this legislation. Thus, the extensive direction given throughout the bill appears to be modified by leaving it up to the FCC to both create competition and to impose almost any requirements to insure the provision of "an essential public service." The scope of that discretion authorized in section 205 injects the FCC into management decisions. There is currently a line drawn—the regulators should regulate and the managers should manage. Admittedly, sometimes the line between the two becomes blurred. This action does more than blur the line, it seemingly erases the line.

Even though the Basic Exchange Maintenance Program is to be administered by a permanent Joint Board, in reality, this appears to be more FCC involvement in the management and finances of private companies. A Joint Board is a fact-finding and advisory concept. Its recommendations are not binding on the FCC. It is not an administrative body by definition or intention and is certainly not a permanent administrative body.

Even though the BEMP formulas are fixed by law and there is no discretion left to the Joint Board or to the FCC, we strongly oppose the administration of this fund by a joint board, the FCC, or any other government agency. There is no reason at all why our industry cannot adequately administer this or any other fund involving revenues of our industry. We are not objecting to adequate oversight by a joint board, but we do object to our regulators also having the authority to administer any part of the funds of this industry.

The FCC is further involved in management under section 214(e) which is intended to permit joint planning by two or more carriers. Joint planning is a day-to-day, ongoing process. It is not an occasional meeting. That section brings me to one of the most important problems in this legislation.

I believe this Subcommittee should recognize that the switched telephone network is the reason we enjoy the highest quality telephone service in this country and the reason subscribers we serve can reach any other subscriber anywhere in this country. In many other countries of the world, a long distance call is an adventure of uncertainty. Not here. My company, the other Independent telephone companies, and the Bell System jointly provide an integrated switched telephone network permitting calls from anywhere to anywhere.

That network is jointly provided, planned, and managed so that all of the providers meet their obligations and make their business decisions to benefit the entire network rather than strictly for their own local company interests. Some may believe that long distance telephone service is provided by Bell Long Lines. Long Lines does participate to a very significant degree, but every telephone company, Independent and Bell alike, plays an important role in completing the total network. We are all part of it.

Our industry has said repeatedly that we are different. We are not the airlines industry, or the railroads, or the electric companies. A telephone in my territory and the equipment our companies use are directly inter-related with the telephone and the equipment anywhere else in the network. There is no other network like the telephone network in any other industry.

Further, the competitors who have entered the telecommunications market and who provide like-services have not become a part of that network even when fully interconnected with the network and even when using part of the network to provide the services they sell. The other carriers provide an alternative service to be sure but an alternative or substitute for network telephone services is entirely different from offering a replacement for those services. They serve selected routes and selected subscribers. Their services are not open to all comers, and in the foreseeable future, it does not appear that the other carriers will replace the need for a network to serve everyone.

The point is the other carriers are not integrated into the network, they are only interconnected. The integrated network permits the entire network to be used as needed to serve all. Routing of communications traffic can be made over any part of the network as the need requires without concern for who owns or controls what piece.

The other common carriers use the network but are not part of it. They use it for local distribution and often to piece out their intercity service offerings. But the facilities the other carriers own are not available to the ordinary telephone subscriber or for use by the telephone industry for routing ordinary telephone traffic.

Although it is difficult to find a similarity, our system of highways, roads, and streets may be somewhat the same. It too is partly provided on an integrated basis by separate entities—the cities, counties, states, and Federal government. This combination of roadways permits anyone in our country to travel from anywhere to anywhere. If a road is closed, another route is available. It does not matter what travels over the roadway. It could be pedestrians, bicyclists, automobiles, trucks, buses, and so forth. The roadway network is there. It is the backbone transportation facility available for all the public to use.

Now there are other alternatives to be sure. There are the railroads and the waterways and the airlines. Each of these provide a type of transportation from one place to another, but not from everywhere to everywhere. None could exist efficiently without the nation's roadways. Airports can shut down or railroads can go on strike and people continue to travel. There may be inconveniences to be sure, but commerce continues to function. However, if the roads, highways, and streets were closed, everything stops. You have experienced that fact in Washington, D.C. during demonstrations blocking traffic arteries. This past winter during a massive snow-storm, the city came to a standstill. The airlines and the railroads are ineffective substitutes because people cannot reach them, and they serve only specialized needs. Those alternative methods of transportation, even though important, are dependent upon the road network for their survival.

Likewise, the other common carriers depend in large measure upon the continued viability of the national public switched telephone network for their success. We provide them with a capability they must have to offer their alternative to the telephone service we also provide to the public.

I believe that if this Subcommittee is intent upon preserving the concept of universal service at reasonable rates, it must specifically address and provide for the continued joint provision by telephone companies of an integrated switched telephone network. It must permit the companies to jointly plan, build, own, operate, and manage a nationwide telephone service network. It must insure that the companies engaged in that joint venture can receive a fair financial return for their joint investment and effort.

I don't believe this Subcommittee intends to simply substitute the new carriers for some of the old. I believe your idea of competition is what you have defined in this bill. This would permit interconnection with the network and the provision of alternative telecommunications services.

Although I am convinced that the average subscriber will not benefit from competition, I understand that competition is here. Our industry is willing to help design a plan that will preserve for this nation the benefits of an integrated telephone network while also permitting competition. But care must be taken now to insure the result does not fragment the network or impede our industry's approach to network planning and management. If there is no network—if each carrier subordinates his decisions to the narrow interests of his company without concern for the needs of the nation as a whole—then universal service at reasonable rates may be a thing of the past.

I urge this Subcommittee to place great emphasis on the priorities of national policy. Insure that our nation as a whole is served, which I believe requires the preservation of the telephone service network. Keep that network healthy, for it is the heart of our telephone system. Destroy the network, and telecommunications may be available to the few but not the many.

Although most of what I have discussed is directed toward S. 611, I have not overlooked the provisions of S. 622. The latter bill is shorter, simpler, and more straightforward in its approach to many of the issues. However, it also seems to confuse an interconnected network with an integrated network.

It emphasizes the obligation to interconnect. It even provides for a procedure to insure interconnection and the formation of an association of common carriers to manage the facilities providing telephone toll service and interconnection with the facilities of local exchanges. The bill also recognizes that joint providers might face antitrust problems in managing a joint endeavor. However, it is not clear to me that this bill is on target. I cannot see that it recognizes and provides for an integrated public switched telephone network which, as I have explained, is operated for the benefit of everyone and which is far different from a group of carriers who are simply interconnected.

Most of my associates in the Independent telephone industry and I are no longer arguing for monopoly as opposed to a more competitive world. We recognize that there will be more competition than in the past, and we hope that the telecommunications industry of the future can be an improvement upon even the outstanding system we now enjoy in this country.

However, believing that a network provided by the telephone companies and alternative competitive services are not incompatible, does not mean that we can agree with the position in S. 622 which instructs the FCC to devise a program to accomplish full competition within a period of six years. It was the FCC's competition policies adopted without a Congressional mandate which brought us to Congress urging a national policy guiding our regulators. This bill imposes on the FCC a mandate without guidance and without firmly defining the priorities the FCC must consider.

Diversity of telecommunications services, competition, and deregulation must be balanced to find how best to serve the American public. The public interest is not served if the public pays more for a lower quality of service.

I have not addressed every section of either bill. There are many other troublesome areas which concern me and our industry as a whole. I know that a number of panels, including telephone industry people, have testified concerning many of these issues.

I have tried to accomplish three purposes; first, to indicate the bills contain ambiguities, second, they try to balance the choice between universal telephone service and competition without first considering the priorities as to which will best serve the public, third, to explain the difference between an integrated network and one that is merely interconnected. This Subcommittee must understand that difference and must choose carefully between the two types.

Both Cencom and Ace Telephone Association which I represent here today have proud records of service to a rural portion of America. We accomplished this as private businesses but also as part of a greater telephone industry enterprise. We need for you to help us, through the policy you devise, to continue to bring to rural America—to all America—the finest possible telecommunications services. We need you to insure that customers all over America do not suffer from a policy which encourages competition at the risk of crippling the public telephone network which serves everyone.

Senator HOLLINGS. Thank you very much.

Mr. Doud.

Mr. DOUD. Thank you, Mr. Chairman.

I appreciate this opportunity to present IBM's views on the domestic telecommunications provisions of S. 611 and S. 622. My remarks this morning will highlight IBM's position, but I have provided a more detailed statement, which, with your permission, I would like to have included in the record.

At the outset, I wish to commend the subcommittee for its work on these bills. It appears to us that both sides of the aisle have made a conscientious attempt to address the issues which we feel are crucial for the evolution of a national telecommunications policy that will meet the current and future needs of the American people.

In our view, you have done so with considerable success.

We at IBM are particularly pleased by the emphasis in both bills on deregulation and increased reliance on competition. We share the conviction of the sponsors that unregulated competition provides an important stimulus to technological innovation, and is the most effective way to assure the widest variety of new products and services at reasonable charges.

And we agree with the proposed congressional finding, explicit in S. 611 and implicit in S. 622, that low-cost, universal, basic telephone service must and can be maintained in an environment of increased competition.

There are other aspects of the two bills which we heartily endorse, such as the need to deal with the A.T. & T. consent decree.

These are discussed in my prepared text. But I would like if I may, in the short time allotted to me, to go to the heart of what troubles us about the proposed legislation.

This is the apparent concern evidenced in S. 611 that some regulatory control has to be maintained over the information processing as well as the telecommunications activities of A.T. & T.

Now, Mr. Chairman, we at IBM draw a very distinct and firm line between these two categories of activity. And we feel very strongly that they require quite different treatment.

We believe that telecommunications regulation should be limited to basic transmission services that is, the transport of information of the user's choosing, unaltered in form or content, between points specified by the user.

To jump right to the punchline, if I may, while we are inclined to agree that some continuing public utility regulation of A.T. & T.'s basic transmission services may be required, we see no need whatsoever for any such regulation, even for a limited period of time, of A.T. & T.'s other services or of its provision of customer premises equipment.

Our reason for this belief is that the information processing marketplace is characterized today by a high degree of effective

competition, unlike portions of the telecommunications marketplace in which A.T. & T. is the major factor.

In our view, therefore, since the premise is wrong; namely, that the information processing marketplace needs to be protected against A.T. & T. participation—the proposed solution, that is, extending FCC jurisdiction to encompass information processing—is also wrong.

Nor, may I add, is that solution necessary in order to preempt State regulation of customer premises equipment, and services providing more than basic transmission.

That issue can be dealt with in a much more direct fashion, by simply prohibiting State regulation in that area.

During testimony last week, Mr. Charles Brown, chairman of A.T. & T., was asked whether an expanded concept of universal service should be guaranteed through legislation or made available in a competitive, deregulated marketplace.

Our answer to that question is that, as technology advances and competition makes available a variety of products and services, the public perception of what is an essential service will expand.

Data devices in the home will become the norm, rather than the exception. But it would be completely contrary to the stated goals of your proposed legislation to begin an era of increased reliance on competition with a legislative broadening of the concept of regulated universal service beyond basic two-way voice service.

The very technology which will bring new services to the American public also justifies your reliance on unregulated competition as the means to that end. If the telephone companies wish to expand beyond basic transmission into new information services, they should be permitted to do so, but only on an unregulated basis.

Now I would like to make it clear, Mr. Chairman, that IBM favors allowing carriers to offer such new information services on a completely unregulated basis, because we believe that to do so is in the public interest, as well as in the interest of the information processing industry.

We hold no special brief to make things easier for A.T. & T., nor do we take the position we do because of our participation as a minority partner in Satellite Business Systems.

We are genuinely concerned that should carrier offerings of services providing more than basic transmission be regulated, such regulation will eventually creep over and embrace similar service offerings by noncarriers.

This we think would be disastrous for the information processing industry and for our national economy.

The information processing industry is characterized by rapid technological innovation, ease of entry, a high growth potential, and vigorous competition.

Therefore, we believe that the Congress need not and should not grant the FCC any jurisdiction over the information processing activities of carriers in order to protect the industry from possible unfair competition by A.T. & T. and other carriers.

Parenthetically, I would like to say that it seems to me that there may have been too much attention given to protecting individual competitors, and not enough to protecting ratepayers.

What is needed are safeguards that will protect ratepayers of basic telephone service from unfairly bearing the costs and risks of carriers' competitive activities. But the same safeguards will also help to insure that carriers who do wish to participate in the provision of customer premises equipment, or services providing more than basic transmission, will do so on a basis that is fair to their noncarrier competitors.

Chief among the safeguards required are rigorous accounting procedures. We are pleased that both bills direct the FCC to insure that revenues and costs attributable to the provision of monopoly and competitive services are separately identified.

In this same direction, we have recommended in the FCC proceeding on the uniform system of accounts for telephone companies that carriers adopt accounting separation among the three major sectors of their activities: Unregulated offerings, competitive regulated services, and monopoly services.

This would enable carriers to assign revenues and costs to monopoly and competitive services as if they were offered by independent entities.

This concept has received the support of Continental Telephone, NARUC, and the California and New York public utility commissions.

I think it is important to note, also, that Mr. Brown testified last week that A.T. & T.'s accounting system is ready to separate the costs and revenues of customer premises equipment.

The second necessary safeguard is to insure that carriers make available to others the transmission component of any integrated telecommunications and information service they may offer—on the same terms as they make it available to themselves.

We believe this requirement is implicit in the present Communications Act, but we recommend that it be specified in the subcommittee bill.

We note that Mr. Henry Geller, Assistant Secretary of Commerce for Telecommunications and Information, has supported such a requirement in his testimony.

I believe the safeguards we propose will prove to be both feasible and adequate, but we do not oppose those provisions of S. 611 and S. 622 which grant the FCC the flexibility to supplement them with some degree of organizational separation if the Commission finds it to be necessary.

In conclusion, Mr. Chairman, I wish to reemphasize IBM's strong belief that the optimum way to achieve our national telecommunications goals, and to avoid the risk of creeping regulation, is to limit the regulatory jurisdiction of the FCC—and of the States—to basic transmission services.

Total deregulation of customer premises equipment, and services offering more than basic transmission, both of which are already highly competitive, need have no negative impact on the maintenance of reasonable basic exchange rates.

Such deregulation can and should be accomplished now.

Although we have recommended various changes in these bills, I would like to say once again that we applaud their general deregulatory thrust.

Thank you.

[The statement follows:]

STATEMENT OF WALLACE C. DOUD, VICE PRESIDENT, COMMERCIAL AND INDUSTRY
RELATIONS, INTERNATIONAL BUSINESS MACHINES CORP.

Mr. Chairman and Members of the Subcommittee, my name is Wallace C. Doud. I am Vice President, Commercial and Industry Relations, of International Business Machines Corporation. I appreciate this opportunity to present IBM's views on the domestic telecommunications provisions of S. 611 and S. 622. Today, more than ever, national telecommunications policy is critical to the continuing development of the information processing industry of which we are a part, and to the benefits this industry brings to the public and to our national economy.

At the outset, I would like to commend the Subcommittee for its work on these Bills. It appears to us that both sides of the aisle have made a conscientious attempt to address and resolve the issues which we feel are crucial for the evolution of a national telecommunications policy to meet the current and future needs of the American people and, in our view, have done so with considerable success.

The basic goal of telecommunications policy must be to assure the continued availability of rapid, efficient, nationwide and worldwide communications services, with adequate facilities, at reasonable charges, to all of our people. This goal, including as it does the concept of universal basic telephone service, is well stated in the Communications Act of 1934 and we are pleased to see it preserved in the proposed legislation.

But the Subcommittee wisely has recognized that the public's communications needs are changing in this age of rapid technological innovation. The growing diversity of those needs requires the greatest possible reliance on competition. The FCC has recognized this and, under the 1934 Act, has been allowing some competition in selected areas of telecommunications, but—in most cases—on a regulated basis. We believe, however, that in the absence of natural monopoly conditions, unregulated competition is the most effective way to provide consumers with the widest variety of new products and services at the most reasonable prices.

The sponsors of S. 611 and S. 622 are to be regulated, therefore, for establishing reliance on competition as the cornerstone of the proposed amendments to the Communications Act. And we agree with the proposed Congressional finding, explicit in S. 611 and implicit in S. 622, that "basic universal, low-cost public telecommunications services must and can be maintained in an environment of increased competition, through appropriate financial, regulatory and procedural safeguards."

IBM has argued before the FCC and the courts that the FCC has the authority under present law to forbear from regulation in situations where they deem it unnecessary. The FCC, however, has been reluctant to do so—partly because of doubts about the extent of its power to forbear. We are gratified, therefore, that both Bills specifically direct the FCC to regulate only to the extent necessary, thus eliminating any question as to its authority to forbear whenever regulation is not absolutely necessary.

Another factor which has served to inhibit the FCC from deregulating as much as it would like in telecommunications has been the 1956 consent decree prohibiting AT&T from engaging in unregulated activities. As then FCC Chairman Wiley stated in his concurring opinion in the Dataspeed 40/4 proceeding, the FCC's decision to regulate the Dataspeed 40/4 was influenced by its concern that the consent decree would otherwise remove "AT&T's ability to offer data terminals." IBM believes that it is in the public interest that all carriers—including AT&T—be permitted to participate in unregulated businesses, including information processing. We have urged that the consent decree be modified to permit AT&T to do so. Both Bills address this issue, and we urge that the Subcommittee Bill assure that this objective is achieved.

While we are enthusiastic about the overall deregulatory, pro-competitive direction of both Bills, we do have a concern with what appears in S. 611 to be an extension of FCC jurisdiction into the information processing industry, an industry which is highly competitive and requires no public utility regulation. Section 102(a) of S. 611 says that the Act "shall apply to and the Commission shall exercise jurisdiction with respect to: * * * all commerce in * * * electronics equipment and services, information software, and information services." (Emphasis added.) Although Sections 203(a) and 203(e) seem to take away much of the jurisdiction apparently granted to the FCC in Section 102(a), we find this overall approach to FCC jurisdiction extremely troubling. Extension of regulatory jurisdiction to competitive areas—including the sale of equipment and services which in the past have been totally free of economic regulation—would be the very antithesis of reliance on competition.

We understand the Subcommittee has two principal objectives which may explain the current wording of Section 102(a): First, to preempt the states from extending regulation beyond basic local exchange telephone service; and, second, to maintain control over AT&T's activities, not only in basic transmission, but in all other areas as well. We are convinced that these objectives can and should be dealt with in other ways which will be equally effective and far less troublesome.

On the first point, we agree that the objectives of S. 611 could be subverted if the states were permitted to regulate products and services which Congress intends be open to unregulated competition. We suggest that this result be prevented by explicitly limiting state jurisdiction to local exchange service and, equally important, specifically prohibiting state regulation of carrier offerings of customer premises equipment and of services providing more than basic transmission.

On the second point, we support the Subcommittee's position that the traditional telephone carriers should not be allowed to exploit unfairly their position in telecommunications to the detriment of full and fair competition. But once again, the answer is not to use wording which appears to extend regulation to hitherto unregulated activities. Instead, safeguards can and should be established which will ensure that all telephone companies will compete fairly when engaging in unregulated businesses. I will address these safeguards more fully later on.

We recommend, therefore, that Section 102(a) be revised to make clear that the Congress does not intend the FCC to have any jurisdiction to regulate any portion of the information processing industry.

In addition to our deep concern with the general jurisdictional approach of S. 611, I would like to mention several specific jurisdictional issues which, it seems to us, could compound the problem:

First, we understand Section 203(d)(1) to authorize the FCC to establish standards for equipment to be attached to the telecommunications network for the purpose of protecting the network from technical and operational harm, and to do so in a manner which would not have anticompetitive effects. This is a purpose we heartily endorse. But if the statement of purpose in this Section were read disjunctively it would be a major change in policy and would require the FCC to regulate competitive behavior among the several thousand participants in the information processing industry. In view of the deregulatory approach of the entire bill, we are confident that this is not the Subcommittee's intent. We recommend that the language of the Section be changed to clarify that the FCC's role in this area is limited to ensuring that equipment connected to the network does not cause technical harm.

Second, Section 203(e) could be read to establish a double standard under which non-carriers offering data processing equipment and services would not be regulated (except as provided in Section 203(d)), but carriers engaged in the same activities would be regulated. Because of the competitive nature of the information processing industry, and the feasibility and effectiveness of the safeguards I will propose, we believe the Commission's regulatory authority need not and should not extend to the information processing offerings of carriers any more than to those of non-carriers.

Finally, Section 203(g) could be read to permit the FCC to regulate anyone who packages basic transmission as a component of an integrated telecommunications and information service, including even a remote access data processing service. IBM believes that such regulation is unnecessary and unwise whether the packager is or is not affiliated with the provider of the underlying transmission. It is unnecessary, because integrated telecommunications and information services are subject to effective competition, and it is unwise because regulation, especially when unnecessary, is bound to deter entry of new competitors and innovation in such new network services. (Indeed, this provision, and the Bill as a whole, seem to presume that resale of only basic transmission would be regulated. IBM believes such regulation is unnecessary, because the provision of such transmission by the underlying carrier is already regulated.)

We appreciate that the Subcommittee staff shares some of these concerns about misinterpretation of these sections and we will be pleased to work with them to develop new language if they so desire.

I would not like to describe what we believe should be the proper limit of FCC jurisdiction, and why we feel that further extension of regulation is not only unnecessary, but harmful. The telephone companies were granted franchised monopolies in order to assure the provision of basic transmission service via an integrated nationwide network. It was in this area of basic transmission—that is, the transport of information of the user's choosing, unaltered in form or content, between points specified by the user—that effective competition was traditionally thought not to exist. The availability of this basic transmission service is the foundation upon upon which communications-based information processing has been

built and upon which all future services will be built. It is in this area—basic transmission services—and this area alone, that some “handicapping” may be required to allow effective competition to develop. We are inclined to agree with the Subcommittee's belief that a transitional period may be necessary. But it is only with respect to basic transmission that some regulation of competitive activities may continue to be required in order to assure universal service at reasonable rates.

During Mr. Brown's testimony last week, the Subcommittee asked whether an expanded concept of universal service should be guaranteed through legislation or made available in a competitive, deregulated marketplace. It is clear that, as technology advances, the public perception of what is an essential service will expand. However, it would be completely contrary to the stated goals of your proposed legislation to being a period of deregulation and increased reliance on competition with a legislative broadening of the concept of regulated universal service beyond two-way voice telephone service. The very technology which will bring new services to the American public also justifies your reliance on unregulated competition as the means to that end. As we have said many times, if the telephone companies wish to expand beyond basic transmission into new information services, they should be permitted to do so, but only on an unregulated basis.

We urge, therefore, that the Subcommittee clearly define the basic transmission boundary as the outer limit of the FCC's jurisdiction even during any transition period.

The telephone companies, and particularly AT&T, have been indicating an interest in offering information processing services, and they should not be prevented from doing so. But such services are separate and distinct from the basic transmission services now available. Unlike basic transmission services, they are already subject to highly effective competition from numerous carrier and non-carrier entities, and should be entirely unregulated now and in the future. Over two thousand firms are in the information processing services business today, with offerings ranging from traditional over-the-counter service bureau operations to the most sophisticated nationwide time-sharing networks which incorporate the resale of carrier provided basic transmission services. Information processing service revenues reached four billion dollars in 1976, and are expected to grow to fifteen billion in 1985. There can be no question as to its competitive nature.

The growth of the information processing services business has been due in large part to technological innovation in information processing systems. The entire information processing industry has been characterized since its inception by unregulated competition. Users demands and competition have stimulated technological innovation and price/performance improvements unmatched in any other industry. Just one indication of this improvement is in the time and cost to process information. Over a period of just twenty-five years, the performance speed of computers has improved from about 2,000 multiplications per second to over 3 million, while the price for 100,000 multiplications has been reduced from \$1.26 in 1952, to less than one cent today in current dollars.

Mr. Chairman, I believe the Subcommittee will be hardpressed to find another industry which has so dramatically reduced its prices in this era of high inflation as the information processing industry. Quite frankly, we at IBM are convinced that this enviable record would not have been achieved, had the industry been subject to any influence of public utility regulation.

Because the information processing industry is characterized by rapid technological innovation, ease of entry, a high future growth potential, and vigorous competition, we believe the Congress need not and should not grant the FCC any jurisdiction over the information processing activities of carriers in order to protect the industry from possible unfair competition by AT&T and other carriers. We see no need whatsoever to extend regulatory authority to carrier provision of customer premises equipment or information processing services even for a limited transitional period. Rather, as I mentioned earlier, what is needed are safeguards that will protect ratepayers of basic telephone service from unfairly bearing the costs and risks of carriers' competitive activities. The same safeguards will also help to ensure that carriers who do wish to participate in the provision of customer premises equipment, or services providing more than basic transmission, will do so on a basis that is fair to their non-carrier competitors.

Chief among the safeguards required are rigorous accounting procedures. In keeping with the policy trend toward more competition and deregulation, we have recommended in the FCC's proceeding on the Uniform System of Accounts for telephone companies that carriers adopt accounting separation among the three sectors of their activities: unregulated offerings, competitive regulated services, and monopoly services. This would then enable them to assign revenues and costs to monopoly and competitive services as if they were offered by independent entities.

We have been gratified to see that this concept has received the support of Continental Telephone, NARUC, and the California and New York public utility commissions. I think it is important to note, also, that Mr. Charles Brown, Chairman of AT&T, testified last week that AT&T's accounting system is ready to separate customer premises equipment costs and revenues. We therefore endorse the provisions in both S. 611 and S. 622 directing the FCC to ensure that revenues and costs attributable to the provision of monopoly and competitive services are separately identified.

The second necessary safeguard is to ensure that carriers make available to others the transmission component of any integrated telecommunications and information service they may offer—on the same terms as they make it available to themselves. We believe this requirement is imposed by the present Communications Act, but we recommend that it be specified in the Subcommittee Bill. We note that Mr. Henry Geller, Assistant Secretary of Commerce for Telecommunications and Information, has supported such a requirement in his testimony favoring increased reliance on competition and deregulation in telecommunications.

Finally, the Subcommittee Bill should explicitly require carriers to allow customers to connect their own equipment to the telephone network, subject, of course, to the FCC's registration program.

I believe the safeguards we propose will prove to be both feasible and adequate, but we do not oppose those provisions of S. 611 and S. 622 which grant the FCC the flexibility to supplement them with some degree of organizational separation if the Commission finds it to be necessary.

In conclusion, Mr. Chairman, I wish to re-emphasize IBM's strong belief that the optimum way to achieve our national telecommunications goals through competition is to limit the regulatory jurisdiction of the FCC (and of the states) to carrier provision of basic transmission services. Deregulation of customer premises equipment and services offering more than basic transmission, both of which are already highly competitive, need have no negative impact on the maintenance of affordable basic exchange rates, and can and should be accomplished now. Although we have proposed various changes to the legislation, I would like to say once again that we applaud the general deregulatory thrust of these Bills.

Thank you.

Senator HOLLINGS. Thank you very much, Mr. Doud.

Mr. Henson.

Mr. HENSON. Thank you, Mr. Chairman.

Good morning. I am privileged to appear with this distinguished panel. I apparently serve as anchorman.

I first want to express my appreciation to the subcommittee for the privilege of sharing the views of United Telecommunications with you. I also want to compliment the subcommittee and the staff for two excellent pieces of legislation, S. 611 and S. 622.

Mr. Chairman, I have submitted a filed statement. I ask that the statement be incorporated in the record. I shall simply summarize a few of the provisions in both bills that are troublesome to us.

We wholeheartedly endorse the stated objectives of both bills. Certainly the maintenance of nationwide, universal telephone service at reasonable rates is an objective that the Congress and, indeed, the American public must applaud.

Greater reliance on the marketplace and a lessening of regulation over a period of time in telecommunications services are equally laudable objectives.

We at United have advocated increased competition and a lessened degree of regulation for some period of time.

We think that through realization of these twin goals, we will spur innovation in the provision of services in a competitive environment.

Having said that, I must add that we do have problems with some of the provisions in both of the Senate bills.

I will highlight these problem areas of regulatory powers, separate entities, network management, and access charges. I would like to speak to each of those points briefly.

We see in both Senate bills a substantial increase in regulatory powers with no sunset provision in one bill—S. 611—and with an intended sunset provision at the end of 6 years in Senate bill S. 622.

Speaking only for the independent telephone industry, I submit that both bills, insofar as telephone operations are concerned, go from pervasive regulation to oppressive regulation.

During the very transition period in which we are trying to realize these goals of increased competition and lessened regulation, the category II carriers, all telephone companies, shall be subjected to more, not less, regulation.

In the subcommittee's attempt to restrict the dominant market force in the telephone industry today—the Bell System—which serves 80 percent of the local exchange market and perhaps 95 percent of the intercity market—you opted for regulatory constraints in order that competition can thrive.

Seemingly, the Senate committee is following the path of the recent regulatory pattern of the FCC. The FCC has been attempting, through regulation, to restrict the growth and development of the Bell System for some time.

And every time the FCC kicks the Bell System in the shins, they hit the independents in the groin.

I fear that may be the outcome of the Senate bill provisions in their present form. I would, second, like to talk a bit about the need for separate entities. The subject has been discussed here by my copanelists.

I suspect it will be a continuing matter of discussion with the panel. Mr. Brophy has pointed out some of the problems that we foresee in attempting to regulate the market giant in the industry, and has suggested some of the problems that regulation poses for independent companies, particularly rural, isolated telephone companies, if, indeed, arms-length separate entities are required with no common officers, directors, financial structure, employees, or facilities.

The latter conditions—no common employees or facilities—wreak great harm on the independents. The separation increases their cost of doing business and hence increases the cost to the ultimate consumer.

Again, additional regulatory constraints are imposed on the Bell System and the independents in the form of section 214 authority, the authority to construct plant and property. Heretofore, we have only had to apply to the FCC when we crossed State boundaries in constructing interstate transmission facilities.

Those powers have been expanded in S. 611 to include State and interstate transmission facilities, and, more importantly, switching equipment, which heretofore has not been subject to section 214 requirements.

The recognition of the need for network management is recognized in both bills. As one who has lost management rights consistently to the FCC in recent times, I am not enamored of having additional oversight of the management of our businesses.

Yet, again, network management is made subject to the auspices and control of the FCC.

We have been unable to sufficiently inform the Members of Congress of the importance of the public switched network. We have also failed to explain the reasons why it must be operated as an integrated unit.

This point is stressed in my filed statement and I shall be glad to respond to questions during the panel discussion.

In essence, we think it is of paramount concern to the American public if we are to avoid service degradation and if, indeed, new technology is to be employed properly, timely, and in the interest of creating efficiencies, that there be some joint planning for the construction and operation of the public switched network.

We think that joint planning and operating can be done even in a competitive environment while assuring all competitors that there is no attempt to constrain competition.

We must provide more flexibility in the manner in which we undertake joint planning and operation of the nationwide switched network.

Finally, permit me to comment on the structure of access charges for the use of local distribution facilities. Access charges will cushion the transition from the present separations and settlements processes which have been utilized in the telephone industry. Such processes have been directed by both our State and Federal regulators. I quite agree that the time has come when we must reassess the manner in which partners in the public switched network are compensated for their investments and expenses.

The access charge concept certainly has our wholehearted endorsement. We do believe, however, that the States should exercise jurisdiction over the level of access charges. That philosophy is not reflected in the provisions of either Senate bill.

We are concerned that the formula may cause an abrupt shock on local rates in some instances. We would like to suggest a tuning or a fitting of the formula to avoid these serious economic dislocations.

In conclusion, we fully support the twin goals of marketplace competition and lessened regulation.

We do believe that under the provisions of these bills, the regulatory powers of the FCC have been increased unnecessarily.

We believe that the potential operational and economic cost to the public if the public switched network is fractionalized by artificial barriers and regulatory prohibitions may be severe.

We are also concerned about the probable impact of the access charge structure on local service rates.

Having said all that, I will conclude by saying that there is an urgent need for legislation. We think both Senate bills have made an excellent start toward finding a reasonable solution to the dilemma in telecommunications policy in this country. Thank you.
[The statement follows:]

STATEMENT OF PAUL H. HENSON, CHAIRMAN OF THE BOARD OF UNITED
TELECOMMUNICATIONS, INC.

Mr. Chairman, I appreciate the opportunity to appear before this Committee and share with you our thoughts about proposals to amend the Communications Act of 1934, as contained in Senate Bills 611 and 622.

I am Paul H. Henson, Chairman of the Board and Chief Executive Officer of United Telecommunications, Inc. (United Telecom) which is headquartered at 2330 Johnson drive, Westwood, Kansas. Westwood is a suburb of Kansas City, Missouri. I am a graduate of the University of Nebraska with a master's degree in electrical engineering. In 1959, I joined United Telecom as Vice President after serving 15 years with the Lincoln Telephone and Telegraph Company. Except for military service, my entire work experience has been in the Independent telephone industry.

United Telecom and its affiliated companies are deeply involved in both the telecommunications and the computer service industries. United's telephone operations, which comprise the second largest Independent operating group, provide the bulk of our revenues and earnings. United Computing Systems, Inc. offers a wide variety of business, technical and financial services via an international data communications network linking computer centers in Kansas City, Boston and London. North Supply Company distributes the telecommunications products of more than 300 manufacturers domestically and internationally, through distribution centers utilizing extensive computer controls. A summary of United's principal operations is shown on the attached Exhibit.

United Telecom is a large organization by many standards of comparison. However, in the telecommunications industry there is a tendency to relate every dimension to those of AT&T, and even to suggest, with such potential competitors as IBM and ITT, of a "coming battle of the giants." When judged by the financial parameters of these corporate giants, United Telecom's annual revenues and sales of \$1.5 billion, and assets of \$3.4 billion, are not very large.

It is more appropriate, perhaps, to think of serving some 2.5 million telephone customers with some 4.2 million telephones, through 24,000 employees, employed by 25 companies, in 3,000 communities in 20 states. Our telephone companies are representative of many of the 1,500 Independents who furnish some 30 million telephones throughout about half of the area of our country.

It is useful, also, to put these figures into context. Thirty million telephones is more than the number existing in any other country in the world except Japan. It is more than the number existing outside the U.S.A. on the continents of North and South America.

Forty-five years have passed since the Congress last determined the national policy concerning communications for citizens of the United States. In this period of two generations, entire new industries have come into existence which are affected by this policy, and many generations of technology have greatly enlarged opportunities for the use of telecommunications in the conduct of our business and social affairs.

The time is right to reassess our values and our needs. Much has changed which needs to be reflected in our national policy. Much has also been accomplished which is worthy of being recognized and protected by the law and by those institutions of government to which we look for the implementation of policy.

One thing which has not changed is the fundamental goal of the 1934 Act, retained by both of the legislative proposals. I quote the wording of S. 611, Section 102: "For the purpose of making available, so far as possible, to all the people of the United States, rapid, efficient, nationwide and worldwide telecommunications services with adequate facilities at reasonable charges * * *"

We, too remain dedicated to this objective. I submit that our industry has performed in a way which is consistent with this goal. Such words as "rapid," "efficient," "adequate," and "reasonable" are relative terms, subject to personal interpretation. But if the experience of other nations is relevant, we, in the United States, have achieved and maintained telephone services which closely approach the stated objectives.

Still more and better telecommunications services are possible, and the FCC and the Courts have determined that they are most likely to be achieved in an environment of competition. We accept this determination as irreversible fact. It may even have been a wise decision, if—but only if—we proceed with the overriding consideration of avoiding the destruction of what we have already built. The unintended loss of those benefits now provided by our high-intergrated telephone system could occur if we fail to recognize and protect the underlying supporting structure on which it is built.

We join with the sponsors of the legislation before this Committee in the challenging effort to find ways to increase customer choice and provide incentives for innovation and efficiency, without sudden or serious impairment of our traditional goals of universal service at uniformly moderate cost.

My statement consists of comments on both the general philosophy and specific objectives of S. 611 and S. 622. We have not attempted a section by section analysis

at this time, choosing rather to confine our remarks to the provisions which concern telecommunications services.

The objective of the proposed legislation is specifically reflected in S. 611, Section 101 of the Act:

"* * * for the purpose of encouraging diversity of ownership and control among telecommunications media and competition among telecommunications media * * *"

And in S. 622, Section 225(a) of the Act:

"The purposes of this Section are—(1) to provide as soon as practicable for marketplace competition in all telecommunications service * * *"

Most of us support the concept of free market competition, in the abstract, as the most efficient means to obtaining more and better products and services. In practice, some competitors have reservations when they encounter, for the first time, a competitor offering a more attractive service or a lower priced service. They are tempted to protest loudly and seek some source of regulatory or judicial protection.

On the other hand, some regulators find that they have reservations both the real effectiveness of free market forces when they are asked, for the first time, to relax regulatory control over service and price decisions.

The dream of the "free lunch" being universal in human society, it is no wonder that all of us look for opportunities to "have the best of both worlds," or "have our cake and eat it, too." We are reluctant to admit that the virtues of a competitive free market economy rest upon a foundation to risk and reward, of success and failure—and of business managements required to accept the decisions of the marketplace.

The other side of that coin, of course, is the need to accept market forces as the regulator. In the proposed legislation, we find in S. 611, Section 202 of the Act:

"* * * the Commission shall exercise only so much of the powers conferred upon it * * * as is essential * * *"

And in S. 622, Section 225(d) of the Act:

"* * * such regulations (of the Commission) shall * * * result in marketplace competition in and the deregulation of the provision of telecommunications services."

The proposed amendments to the 1934 Act express the intent that regulation will diminish over time—six years being specifically suggested in S. 622. Since the self-disciplines of a competitive free market environment are imposed, gradually, on a reluctant industry, one might suppose that they would be imposed, gradually, on that industry's regulators, as well.

We, at United Telecom, have accepted the challenge of competition for a long time now. We have also expressed, on many occasions, our belief that competition is essentially incompatible with regulation. That is not to say that the two cannot exist together, for they do so to some degree in nearly every business. However, we submit that as competition is increased, regulation should be decreased. Management can strive to satisfy the market or it can strive to satisfy regulation. Management should not have its major decisions directed, for an extended period of time, toward the satisfaction of both the market and regulation.

We are disappointed to discover that under both of these Bills, the concept of regulated competition, which we reject, appears to be accepted as the norm. Senate Bill 611 leaves deregulation entirely to the Commission's determination to cease to exercise the powers granted to it by the Act. At the same time, the Bill substantially increases both the power of the Commission and the discretionary judgment with which it may exercise that power.

Senate Bill 622 directs the Commission to plan for deregulation and to report progress to Congress. At the same time, it moderately increases the discretionary power of the Commission.

We are concerned that this increased degree of regulatory authority will tend to lead to the handicapping of competitors which, in turn, will inhibit innovation and reduce efficiency. There is a need for a transitional period to avoid serious and sudden impacts during the restructuring of the telecommunications industry. We encourage the Subcommittee to acknowledge that need in the Bill by providing for a mandatory reduction in Commission authority, over, a span of from five to ten years.

FRAGMENTATION OF THE INTEGRATED NETWORK

We are concerned that the provisions of S. 611 which would restructure the industry will so fractionalize it as to destroy its ability to continue to provide universal service on a basic nationwide network at reasonable cost. The fractionalization prescribed under Sections 203 and 205 of the Act would require fully separated corporate entities for exchange service carriers; Category II interexchange public

message telephone service carriers; other interexchange telecommunications carriers; entities selling or leasing telecommunication or electronic equipment; information software or information service providers; and any Category I carrier service. Not only would this forced separation of companies and their assets be wasteful and uneconomic, but perhaps impossible to accomplish, as holders of bonds and debentures are unlikely to accede to such division of the underlying assets for their securities.

As an example, one of the operating telephone companies in the United Telephone System is the Carolina Telephone and Telegraph Company (C.T. & T.). That company provides local exchange telephone service in the cities of Fayetteville, New Bern, and Tarboro, North Carolina, among others. It also provides interexchange public message telephone service between those cities. It also provides interexchange telecommunication other than message telephone service between these three cities. In none of these markets does it have effective competition. The provisions of proposed Sections 203 and 205 would require C.T. & T. to split its assets and operations into three separate affiliated carriers, with no common officers, directors, or employees, or common facilities. Leaving aside the obvious inefficiencies of these fragmented operations, one can only assume that the holders of the debt securities of C.T. & T. would require complete refinancing, at substantial premiums, of all of those securities which were sold over the last 15 to 20 years. This is not an idle speculation. It is a "most likely" scenario if we are compelled to segregate the assets into two or more additional corporations. Waiver of most of the separate entity requirements is authorized, but the provisions make it abundantly clear that Congress intends waivers to be the exception to the rule, appropriate only in rare instances.

We submit that divisionalization, with proper cost accounting, would provide equal assurance that competitive services are not subsidized by monopoly services. Divisionalization would permit the retention of the financial and operating efficiencies which presently exist.

All of us, of course, have every intention of preserving our nationwide telephone network. It is something we take for granted, and when we think of it, if we do so at all, we think of it as indestructible. To plan, build, operate and maintain this network requires constant coordination and cooperation among the 1,500 telephone companies who take it as their responsibility to ensure that both local and long distance capability is available to each of their customers.

To think of this network as anything but a unified system—as just a collection of piece parts, or even as made up of independent segments—is inconsistent with the objective of assuring universal voice telephone service to all.

In the competitive world which lies before us, we see no other company or group of people even remotely interested in providing a system which assures availability and reliability to all. Certainly there are many interested in providing selected parts of that system, where either protective umbrellas of existing rate structures or heavy traffic volumes make it profitable to do so. We have not seen anyone clamoring to assure that Cousin Lucy in Bingen, Washington, can talk to Uncle Luke in Tightwad, Missouri.

Throughout three years and countless meetings on this subject, it has really been a bit frightening to observe the casual assumption made again and again that the network is not really threatened by any of these policy debates. The reasoning seems to be that AT&T is the network, and that however the Bell System may be hobbled, the network will stand firm.

There is a common but erroneous assumption that AT&T's Long Lines Department provides most, if not all intercity connections. Actually, Long Lines furnishes only a small part of today's intercity facilities, and only the largest of the many switching nodes.

The network already has a diversity of corporate owners, and yet is highly integrated, both technically and operationally. The Bills should explicitly provide for the continuation of this jointly operated network in competition with other interexchange carriers or networks, so long as the local exchange carriers do not discriminate against other interexchange carriers' use of the local distribution facilities in regard to terms, conditions or prices.

The Bills recognize the need for joint management of a basic network, but in neither does there appear to be an appreciation of the extent and continuous nature of the effort involved. The administrative provisions are not consistent with the demonstrated needs for joint activity. The Bills should recognize that the telephone industry operates under contracts which provide what is generally referred to as a partnership arrangement. In effect, through tariffs and traffic agreements, the participating carriers agree on points of connection, quantity and type of facilities, and on other operational matters. The commissions are given authority to resolve

disputes on rates for joint through services, establish exception rates, and division of revenues. Existing coordination arrangements could continue and thus retain technical and operational integration without sacrificing other objectives. Thereby:

(1) An interexchange carrier could establish a new price for a particular service or route within the limits set by federal regulation, with enough public notice to satisfy practical marketing needs.

(2) Billing arrangements could remain unchanged so long as participants in joint through services remain in agreement.

(3) Settlement arrangements could be modified as required to accommodate the transition to access charges.

(4) To preserve the nationwide average toll rate structure and to prevent sudden and serious economic dislocations, the pooling of revenues to cover the costs of the interexchange facilities of those carriers operating the basic nationwide network could be continued during a transition period.

Every segment of the network is planned, implemented, and operated with the goals of nationwide service in mind. Underlying the actual implementation and operation of the network are literally hundreds of support systems which gather traffic data, analyze fault locations, coordinate cutovers of new switching centers, transfer billing information on third party calls, etc., all supported by and coordinated among the 1,500 telephone entities providing portions of the nationwide service.

This high degree of technical integration also requires an equally high degree of operational integration among partners. Currently, nationwide telephone service is operationally integrated because all of the partners' investments and expenses are treated as one, and each partner shares in the profitability of the joint enterprise. This operational integration provides strong incentives for each telephone entity to make the appropriate investments and spend the necessary expense dollars to keep its portion of the network up to the high standards which universal service requires.

Changes in the network are being made constantly, to accommodate new needs and achieve economies. While these changes are good for the whole enterprise, they are not necessarily, in the short run, attractive to individual companies. They may, in fact, require substantial investments for little or no immediate return.

The economic incentive to pay for local network improvements which are not immediately advantageous would, of course, be removed completely by the proposed structural and settlement changes.

These investments are made because the separations and settlements process assures appropriate compensation to the company which makes them. Take away this operational integration, and the network is immediately vulnerable to deterioration.

Any radical restructuring which results in a fractionalization of ownership and of markets will sever the coincidence of interest within the industry in the overall development of the system as a whole. It suggests an evolution toward each segment of the network becoming financially self-supporting. Economies of scale realized in one portion of the network would no longer be shared equally, or even shared at all, among all subscribers.

We are also concerned with the power given to the Commission to classify carriers, markets and services as not subject to effective competition without substantive standard. In S. 611, the only definitive standard set forth is the prohibition against finding a carrier not subject to effective competition if the carrier has no more than 33 percent of the market. We submit that a carrier is subject to effective competition with respect to a particular class of service or market if a competitive alternative is present which has the effect of restricting the carrier's freedom to change price or terms of such service without significantly affecting the demand for the carrier's service.

UNEVEN REGULATION

United Telecom broadly endorses the stated objectives of both Bills, including the goal of fair competition. However, the uneven regulation among competitors appears to invite unfair competition. We are concerned that the extended period during which the industry will experience regulated competition, regulatory hand-capping, or regulatory allocation of the market, may preclude the achievement of these objectives.

The legislation addresses the difficult problems that arise when competition is introduced in markets that are presently dominated by existing telephone carriers. Any legislative solution relying on pervasive regulation is complicated by the countervailing forces of the marketplace. Hence, the public interest is at stake.

The telephone network can carry other services at a very economical incremental cost. This capability presents formidable competition for new services to any other

carrier. In our efforts to introduce competition in intercity markets, we must not deny the public these potential economic benefits.

One way to temporarily satisfy these incompatible objectives is to retain the nationwide averaged toll rate structure through a defined transition period. It is a demonstrated fact that other carriers, through interconnection at the exchange level, can supply competitive intercity services between major population centers at rates below the price umbrella afforded by the nationwide averaged toll rate structure.

In order to achieve effective competition, it is necessary that competitors survive, and that some prosper. Therefore, those who choose to offer intercity services between selected points are protected by the continuation of the umbrella of average prices. They need not—and should not—be further protected against incremental cost pricing by the operators of the public switched network. To do so is to deny the public all benefits of competition.

In short, the telephone carriers could be temporarily prevented from competing as effectively as they might, so that competitors can become established. The present Commission has demonstrated that it believes that the benefits of this course of action will outweigh the costs—a view which we are prepared to accept temporarily, albeit without enthusiasm.

Since the fundamental objective of the legislation is “to provide as soon as practicable for marketplace competition in all communications services,” we trust that an indefinite period of handicapping is not intended. Hence, we suggest that a specific termination of pervasive regulation of telephone carriers by the Commission be included in the legislation. Further, we suggest that market forces be given a larger role in shaping the future than is likely to occur under the uneven regulation which will result from what appears to be unconstrained regulation of the telephone carriers, and little or no regulation of their competitors.

PRICING

We are pleased to find in the Bills, a clear intent to allocate costs of exchange operations among local exchange, intrastate toll, and interstate toll services in order to continue support of local service at reasonable rates comparable to that occurring under “jurisdictional separations.” Under the provisions of proposed Section 220 of this Act in S. 611, this support is divided into a direct reimbursement of local exchange carriers by interexchange carriers “for the *actual costs* of originating, terminating or transferring interexchange telecommunications service” together with a surcharge to support exchange service at affordable rates. We are concerned at the use of the standard “actual costs” without more explicit definition.

Only a small portion of the costs of local exchange distribution facilities arise solely from their use for interexchange telecommunication service. On the other hand, only a small portion are caused solely by their use for local exchange service. The major portion of the costs of local exchange distribution facilities are fixed costs not varying with use. Still, they are actual costs of any service using the facilities and should be allocated as such. We suggest that the words “actual cost” in lines 12 and 13, Section 222(a), Section 223, S. 611, be expanded to read, “an allocation of all costs and expenses of jointly or commonly used facilities based on relative use.”

There is considerable risk that the early termination of present separations and settlements procedures, and the immediate reliance upon access charges derived from a new formula, will produce significant unplanned effects upon the local rate structure. Even assuming that the allocation of costs of commonly used plant were included in “actual costs,” preliminary analysis suggests that the application of the procedure described in S. 611 would require offsetting local rate increases in the first year, in exchanges served by United, up to 6% in some locations, and to nearly 50 percent by the fifth year.

This result is probably larger than was intended, but it illustrates the difficulty caused by major changes to a complex process. We believe it is preferable to change the present procedures in small ways toward an eventual goal, rather than abandon them in favor of this or any other formula, applied precipitously.

CONCLUSION

Both Senate Bills 611 and 622, in their stated objectives, put considerable emphasis on the twin goals of lessened regulation and the development of marketplace competition. We wholeheartedly endorse these objectives as being appropriate and attainable.

We respectfully submit, however, that the regulatory powers of the Commission are substantially increased during the very transition period in which marketplace competition is presumably to be developed. We can only conclude that such provi-

sions would tend to perpetuate the present handicapping system of market allocation under the guise of competition.

We are equally concerned about the potential operational and economic costs to the American public if the present integrated public switched network is fractionalized by artificial barriers and regulatory prohibitions. We believe that it is possible to retain the benefits of that public network while providing competitors the assurance that they will have equal access to the use of local exchange distribution facilities without discrimination.

We are deeply concerned about the probable impact on prices for basic exchange telephone service, particularly in the sparsely populated areas of the country. Since United's operating areas can be so characterized, we believe that our exchange rates would have to be increased significantly under the present provisions of both Bills.

These comments are offered in a good faith effort to assess the provisions of S. 611 and S. 622. They are intended as constructive suggestions in an attempt to build on the many excellent features contained in both Bills. We stand ready to continue to work with the Committee and its Staff to seek an early and equitable resolution of these areas of concern, if that be the desire of the Committee.

Thank you for the privilege of participating in this hearing.

UNITED TELECOMMUNICATIONS, INC., 1978 SUBSIDIARY STATISTICS

(Dollars in thousands)

	Revenues	Telephone plant	Telephones	Employees
Carolina group—Tarboro, N.C., J. C. Cluen, president:				
Carolina Telephone & Telegraph Co	\$213,147	\$737,915	843,772	4,880
Norfolk Carolina Telephone Co	14,353	56,055	61,819	351
Total	227,500	793,970	905,591	5,231
Florida group—Altamonte Springs, Fla., E. P. Kittinger, president:				
United Telephone Co. of Florida	112,720	350,480	317,326	2,065
Florida Telephone Corp.	92,691	306,585	234,933	1,536
Total	205,411	657,065	552,259	3,601
United Telephone Co. of Ohio—Mansfield, Ohio, R. H. Snedaker, president.....				
	187,365	536,190	634,797	4,231
Midwest group—Overland Park, Kans., C. D. Ehinger, president:				
United Telephone Co. of Missouri	43,509	133,641	177,329	1,086
United Telephone Co. of Kansas	22,281	70,608	99,706	498
United Telephone Co. of Minnesota	18,697	75,041	117,813	447
United Telephone Co. of Iowa	16,545	60,212	98,390	401
Capital City Telephone Co., Subsidiary: Midstate Telephone Co.	11,070	44,184	58,259	283
United Telephone Co. of the West	9,895	37,997	48,009	216
United Telephone Co. of Arkansas	3,808	14,526	24,699	110
Total	125,805	436,209	624,205	3,041
Eastern group—Carlisle, Pa., L. G. Wigbels, president:				
United Telephone Co. of Pennsylvania	78,539	299,404	365,096	1,810
New Jersey Telephone Co.	19,110	64,440	59,282	315
United Telephone Co. of New Jersey	11,780	36,808	41,824	200
West Jersey Telephone Co.	4,406	14,656	14,077	84
Total	113,835	415,308	480,279	2,409
Southeast group—Bristol, Tenn., W. W. Hill, president:				
United Inter-Mountain Telephone Co.	71,494	285,475	305,914	2,042
United Telephone Co. of the Carolinas	18,194	73,375	85,023	320
Total	89,688	358,850	390,937	2,362

UNITED TELECOMMUNICATIONS, INC., 1978 SUBSIDIARY STATISTICS—Continued

(Dollars in thousands)

	Revenues	Telephone plant	Telephones	Employees
United Telephone Co. of Indiana—Warsaw, Ind., G. L. White, president	64,156	213,195	241,364	1,510
Northwest group—Hood River, Oreg., R. M. Crockett, president: United Telephone Co. of the Northwest Subsidiary: California-Oregon Telephone Co.	37,399	123,096	124,404	642
Texas group—Tyler, Tex., V. E. Hix, president: Gulf States-United Telephone Co., Subsidiary: Palo Pinto Telephone Co.	33,797	118,628	120,303	831
Total telephone companies	1,084,956	3,652,511	4,074,139	23,858
Sales or revenues:				
North Supply Co.—Lenexa, Kans., S. F. Fisher, president		\$271,948		346
United Computing System, Inc.—Kansas City, Mo., G. J. Lorenz, president		76,102		1,203
Other operations				720
Total				26,127

Senator HOLLINGS. Thank you very much.

The idea—Mr. Doud, you were talking about taking the intercity exchange MTS long line service—do you think while we separate it out, we don't necessarily ipso facto by statute make it category I or deem it—while competition is in the field we automatically put it in category I, do you think the bill should put it in category I by statute?

Mr. DOUD. Senator, just to be sure I understand, your question is: Should MTS be put into category I?

Senator HOLLINGS. Yes, sir.

Mr. DOUD. I think that really all of the data is not in on that yet. I think we need to take some time before I would be ready to say categorically that it ought to go into one or the other.

Senator HOLLINGS. The general comment is that it's good to have a panel because some say there is too much discretion and some say there is too little discretion given to FCC.

Mr. Henson was just talking that S. 611 leaves deregulation entirely to the Commission's determination.

We see you have less than a third of the market and, of course, you directed, you are in category I, period.

That measure we put in there to try to give some kind of measure—could you give us a more specific measure you would have in mind, so no discretion would be left?

Mr. HENSON. Approaching it from that standpoint, roughly a one-third market share would define a fully competitive market. I would agree that this measure represents at least a starting point.

However, I suggest that there are market forces which might better determine whether or not there is effective competition in a given market.

Senator HOLLINGS. I agree. That is why we leave that to the FCC.

Mr. HENSON. There is the possibility that we might leave it even further to the marketplace itself, rather than the FCC.

Senator HOLLINGS. Then you have the very eloquent testimony of the independents and A.T. & T. that they have to keep up this service.

There should be no deterioration of the network. Do you think we can just come in and deregulate entirely and end up with the fine, integrated network we have now?

Mr. HENSON. No, sir, I don't. Unlike my colleague, Mr. Doud, I think MTS and WATS services in most of the individual markets in the United States will probably be noncompetitive services for some period of time.

There will not be effective competition in all markets at the outset. There will be very effective competition in some markets between major population centers. It is my hope that in those particular markets that we could move to lessened regulation in a very short period of time.

I think the driving force of technology is going to introduce competition in many intercity markets if we give it the opportunity to do so.

That is all I am seeking to say.

Senator HOLLINGS. Let's jump back to Mr. Hostetler.

You were talking about too much discretion in the FCC between category I and II. Do you think you can fix it by law? How would you do that?

Mr. HOSTETLER. Well, first of all, as I think I suggested, I believe the bill ought to indicate that initially the only category II carriers are the telephone carriers. The Commission should be given the discretion to change that classification but the burden of proof should be on the Commission to show after a full evidentiary hearing that that change ought to be made.

As I read S. 611, the Commission makes an initial finding within 180 days. There are no procedural safeguards there.

The Commission can use its own judgment unfettered by any other consideration in defining the marketplace and the various market categories.

So I would leave some discretion to the Commission but I think Congress should set a pretty strict standard.

Senator HOLLINGS. The large number of smaller companies connect into this massive system, which, of course, is dominated by the Bell System. What happens to that in the future under, say, S. 611 or S. 622? It just looks to me as though we plunged into this and have loan deregulation into it. I think that we might have jumped too far into the basic message toll system itself.

Now, we are confusing the new entrants into the system. It looked to me from the beginning, going back quite a few years, that if we could have somehow treated those new entrants coming into the system, they will become part of a new integrated system, something that may look much like it is today except it will have new technology. Mr. Chairman, there is no question in my mind that there will be a need for continued regulation of that basic MTS system for some time to come which means FCC will be around for a while in its regulation.

I just have a real problem with some of the basic ideas set forth as to how we will meet the basic social goals that we have given our lives to in the smaller companies if we lose, via regulation or otherwise, some of the revenues coming across from that MTS system.

Do you feel the same way?

Mr. BROPHY. Sir, I am very concerned we would end up with more regulation rather than less. Let me give you an example.

Section 204(c) of S. 611 provides any carrier who provides either nationally or regionally any telecommunications service or class of service which the carrier is not subject to effective competition it shall be designated and regulated as a class II carrier. Then when we look at the definition in 103, we have the definition of affiliated carrier or affiliated entity and any carrier that owns or controls or is under common control with such a carrier or entity becomes an affiliated carrier and it appears to me we can have an extension of FCC regulation to almost any entity in the country.

My company is in the lighting business. I would see an extension or the possibility of extension of regulatory control to that business. I may be looking for hobgoblins but I am very sensitive at the moment, because I had an experience only yesterday with the FCC that seems to have extended that kind of reach.

We have been in the process of proceedings before the FCC with respect to the proposed acquisition of a company called Telenet. That is a packet-switching company, a relatively small company that has been losing about \$10 million a year.

It's a high-technology company that has the capability of competing with the ACS service proposed to be provided by the Bell System.

Yesterday, the FCC handed down a decision which is not yet available to me and I hope I am not being unduly critical of the FCC—not having seen their decision, I can only say there are decisions I have seen that I haven't been critical enough of so maybe it will balance—but that decision would impose upon GTE as we understand it, restrictions that would prevent Telenet dealing in any way even with nontelephone company subsidiaries of GTE.

For instance, we have a noncarrier subsidiary involved in the provision of brokerage service. Telenet and the brokerage division would not be permitted to use the same individuals to maintain equipment.

The result of the FCC decision, I am afraid, will put us in a position where we can't proceed with the acquisition because it will condemn the acquisition to failure and, therefore, an opportunity for competition will be lost.

I am afraid that there has been an obsession with the FCC, to some extent reflected in the legislation, with the size of A.T. & T. rather than with the quality and cost of service to the public and the introduction of competition that will truly benefit the public.

That's my real concern.

Senator HOLLINGS. Let me yield to Senator Exon.

Senator EXON. Thank you very much, Mr. Chairman. I will be very brief.

I want to address this question to Mr. Henson. We have known each other for a long time, way back when we were both much younger than we are now, in Lincoln, Nebr., and I know he understands the basic telephone systems and networks. Since he comes from a rural State like Nebraska, I want to get to a question that concerns me a great deal.

With all the complexities of these bills that we are addressing here, in your opinion, being a man very knowledgeable in the rural needs of telephones and how important that is to us in rural America, what will happen if one or the other of the bills as presently presented that we are discussing here would become law? What effect would those have on standard telephone rates?

I am talking about the customary telephones in intracity, in towns like 500 to 2,000, and intercity rates between those communities and the larger communities such as Lincoln and Omaha, particularly in Nebraska.

Mr. HENSON. I appreciate the recognition. We did both come from a humble beginning in Lincoln, Nebr.

Senator EXON. Let me interrupt to say he has been consistent. He has been in the telephone industry all his life. This was long before I was involved in the political arena.

Mr. HENSON. I wasn't smart enough to get out of the telephone industry.

It is very difficult to attempt to quantify in specific numbers or in percentages what may happen to intraexchange local service and intercity rates in rural America. All I can say is that they are going to increase over a period of time over and above the inflationary impact of increasing costs of equipment and the inflationary impact on operating expenses.

Permit me to address S. 611 specifically. A basic exchange maintenance program is designed to initially moderate the impact of changing from separations and settlements to access charges. There will, however, be an impact on the small, rural exchange. There will be a further impact as terminal equipment is removed from the determination of the level of access charges. These changes will tend to elevate the price of local exchange service.

Ultimately, as meaningful competition is introduced in intercity markets, the protective umbrella that the telephone industry and its regulators have maintained in the form of nationwide average pricing of their services must respond to the marketplace and prices will be driven toward costs.

In the small, rural, isolated telephone exchange, today's costs are higher. There simply are not the economies of scale that associate with a large quantity of calls. I know that is terribly unscientific. The impact is simply not quantifiable at this point. However, I foresee local exchange rates in rural America escalating under the provisions of S. 611, in addition to inflation-related increases, by some considerable amount.

Our studies show the need for local rate increases in the range of 50 percent to 75 percent cumulatively over a 10-year period following enactment. It is difficult to be precise absent specifics.

Let me also say that perhaps that such increases are not as bad as they may seem. Some of the American public will pay less for telephone services. Those in urban areas, where economies of scale

are substantial, will pay less. This phenomenon is the natural product of cost related pricing.

But, coming from rural America and serving rural America, it does pose some problems. Certainly, it is going to pose some problems for some of our customers.

[The following information was subsequently received for the record:]

UNITED TELECOMMUNICATIONS, INC.,
Kansas City, Mo., May 10, 1979.

Hon. ERNEST F. HOLLINGS,
United States Senate,
Washington, D.C.

DEAR SENATOR HOLLINGS: I have just received the transcript of the hearings held before the Senate Subcommittee on Communications on May 3, 1979. I now realize I could have left the wrong impression by failing to properly qualify and explain my answer to a question posed by Senator Exon.

As I now read Senator Exon's question, it can be paraphrased as follows:

What will happen to the basic service telephone rates, in towns of 500 to 2,000 population, and to the toll rates between such towns and their market centers, if S. 61 and S. 622 become law?

My answer in substance, as contained in the transcript and paraphrased, was that the effect on local rates would be a 50-75 percent increase in such rates over and above the rate of inflation.

My answer was incomplete without further qualification, as it might have appeared I was stating that local rates would be increased 50-75 percent in one year, in addition to the present inflation rate of about 10 percent. I certainly did not intend to indicate that local rates would need to be increased 60-85 percent in any one year.

I actually intended to convey the results of our preliminary studies of the impact of the provisions of S. 611 on the exchanges served by United, many of which are rural in nature. These studies show the need for local rate increases in certain exchanges might be in the range of 50-75 percent cumulatively over a ten-year period following enactment. Such increases would be in addition to those caused by inflation, but offset by any realized annual productivity gains which have been about 5-6 percent in recent years.

We still support the objectives of both Senate Bills and hope that reasonable solutions can be found for this and other transition problems so as to permit early enactment.

I regret the need for this clarification and stand ready to discuss this matter with you or the Staff, if that is your desire.

I request that this letter be made part of the record of these proceedings.

Respectfully,

PAUL H. HENSON.

Senator EXON. Thank you. I thank the Chair. Unless other members of the panel care to respond, I appreciate being allowed to ask questions out of order.

Mr. DOUB. May I have a word on that? As you know, I am not from a carrier and, therefore, I have not had personal experience with that. But we have been very concerned about that issue in IBM as we try to foster more competition and have talked with a lot of people about that subject.

I would respectfully disagree with my friend Paul Henson, and simply say that while that might happen just as he suggests it might happen, I think we have to remember that the present system of separations and settlements is a manmade device. It has been engineered by man. It can be changed by man.

If we really want to keep that universal rate, or rate averaging across the board, while it may become somewhat more difficult as we have greater competition in the urban areas and less competition in the long-distance system in the rural areas, I think that formula can be designed in such a way that there is no reason why

we have to have the rural areas paying a price for the urban areas. We simply have to fix that formula in a way that that doesn't happen.

Senator HOLLINGS. Very good. Thank you.

Senator Goldwater?

Senator GOLDWATER. Thank you.

I have a question for you, Mr. Doud. I am sorry I didn't get to hear your testimony, but this has been bothering me ever since we started this project. I have had very severe doubts about our ability to draft legislation that will take into account new technologies that we can't even think about today, but which all of us know are coming, whether we like it or not.

As a manufacturer of computers, do you believe we can successfully deal with the computers and other technology of the future in legislation we write today?

Mr. DOUD. Yes, sir, I think we can. The way I would suggest we do that is the following—it parallels very closely the counsel we have been giving to the FCC in the computer inquiries they have been conducting over the past several years. It goes something like this:

Rather than attempting to really deal with the issue of technology, we have to deal with the issue of what is an appropriate area for regulation and what is an inappropriate area for regulation.

Technology and the advance of technology can be applied to both areas. Let me illustrate. We believe that basic transmission is the area that should be regulated. Everything else should be deregulated, terminals and additional services on top of the basic transmission.

We know that in the basic transmission area we are going to have significant advances in technology. We are going to be getting away from copper cable and going to start using glass fibers and other kinds of technologies.

We know that computers more and more will be utilized within the basic transmission system to do a more efficient job of getting a message from one place to another even though it may be unchanged.

So technology can be applied there.

But, going over to the other side, the unregulated side, if the rest of it is deregulated, then we don't have to worry about the legislation dealing with that. We can let the natural forces of the marketplace and innovativeness of the hundreds of thousands of companies involved in this area move along with the kind of services the public will want in the future.

Senator GOLDWATER. I am glad you have that confidence. At Bell labs I saw a computer being taught how to speak. It did a remarkable job. I have a hunch that the end result is a telephone company that will have no human beings running it, just computers.

Mr. DOUD. You may have noted a very limited vocabulary.

Senator GOLDWATER. It did have, but they asked me to suggest a word and about the longest word I know is sesquipedalian, and they asked me to spell it and that nearly stumped me. But I did, and that computer came back and pronounced it perfectly.

Mr. Brophy, you were talking about the other bill. My bill approaches this problem in a little different way. We classify common

carriers according to the degree of regulation necessary for each carrier. I wish you would read S. 622 and let me know if you feel that that is a sensible approach or one that will work better than S. 611.

Mr. BROPHY. I would be happy to do that. Surely regulation with respect to specific services or degree of regulation required is a better approach than trying to classify a carrier in its entirety as being in a particular category.

Senator GOLDWATER. Would you let us know your feelings on that other approach?

Mr. BROPHY. Yes, sir.

Senator GOLDWATER. Sitting here day after day listening to the excellent testimony I go away each day feeling that everybody would like to do something about A.T. & T. or Ma Bell's dominance in this whole communications field, but we don't seem to get any specific suggestions other than leaving it up to us. I wouldn't feel safe leaving it up to us.

I would like to have some real thought given to this. I was impressed with Mr. Hostetler's comments today. They were more directly to the point of how A.T. & T. enters into this competitive field.

Would it be objectionable to you if members of our staff visited with you to enable you to develop your thoughts a little more?

Mr. HOSTETLER. I would be delighted.

Senator GOLDWATER. If we are going to be asked to legislate in this field, we need a better idea of where there is competition. I know that A.T. & T. is a pretty big outfit. In fact, it is bigger than most countries in this world. I believe they have a larger income than almost every other country in the world except maybe four or five. That in itself isn't bad, but I would like to know just how they impact on Western Union, for example, or how they affect the other telephone companies that provide a fine service but are smaller and must depend on them.

So I will ask my staff to call you if you don't mind.

Mr. HOSTETLER. Thank you very much.

Senator GOLDWATER. Mr. Chairman, Mr. Henson's company has written a paper on telecommunications policy that I have read and think is excellent. I would like to ask that this paper written by R. M. Alden of United Telecommunications be made part of the record.

Senator HOLLINGS. It will be.

Senator GOLDWATER. Thank you.

Mr. Henson, does "notes" still represent your company's position?

Mr. HENSON. Yes, sir.

Senator GOLDWATER. It is a very good compilation.

Mr. HENSON. Thank you.

Senator GOLDWATER. I don't think I have anything more, Mr. Chairman. Thank you for allowing me to get my two bits in.

Senator HOLLINGS. I wish we had time to get into even more. We have another distinguished panel before lunch today. I think, Mr. Hostetler, you described a situation with respect to the FCC—I heard it described in testimony before that, actually, while we have been all grasping around to find A.T. & T.'s costs, you say they

have more evidence and more records and cost accounting information over there than they could possibly use.

On the contrary, what they are doing is—you used the expression exploiting the diversity of opinion to get a deadlock where nothing is done. That could well happen in this committee.

I want to thank each of you. If you have any addendum to add on to your testimony, we would welcome it. We appreciate your appearance.

[The material referred to follows:]

NOTES ON TELECOMMUNICATIONS POLICY—A POSITION PAPER BY R. M. ALDEN,
PRESIDENT, UNITED TELECOMMUNICATIONS, INC.

INTRODUCTION AND SUMMARY OF CONCLUSIONS

In earlier discussion notes, which last appeared in a draft dated 11/22/78, we approached the broad question of national telecommunications policy from a direction which was new, at least for the telephone industry. The question was put in essentially these terms: If the industry wanted to unite in support of a policy favoring competition to the maximum feasible extent, with a minimum of regulation, could such a policy be made to work?

The conclusions which were reached during the preparation of those discussion notes did not answer the question, but they did suggest the possibility of an affirmative answer, given the following conditions:

- A. Freedom for common carriers to enter any competitive market.
- B. Federal jurisdiction over intercity services, even though within a single state.
- C. A terminal equipment market free of regulation except for technical standards.
- D. Reduced regulatory control over local exchange service, limited to service availability, quality, and price.
- E. Continued support of local exchange costs from the providers of intercity services.
- F. Minimal regulation of intercity services, specifically not including service and price.
- G. Assurance of the rights of carriers to associate for the purpose of network planning and management and the provision of joint through services.
- H. Unrestricted use of local exchange plant and services, except for technical requirements.

Continuing from the premise that these conditions might be established through new federal legislation, we have again sought to answer the question: "Could such a policy be made to work?" We have attempted to describe how each market might function under such conditions—not to identify the best way, but only to show a possible way, having consequences for the carriers, their customers, and their stockholders which might be acceptable.

These descriptions are not yet precise, for each level of exploration exposes questions as well as answers. We are at the point, however, where we are uncovering more of the latter, for a net gain in favor of the proposition that increased competition, accompanied by proportionally less regulation, may not be hazardous to the public interest.

Words always take on meanings which are colored by the experience and point of view of the reader. In the following statements the idea of "deregulation," however stated, is meant as a relative condition suggesting the removal of special protection and restrictions not usually applied to other businesses. Even then it is not an exact term; it does not say how much has been removed, nor how much remains.

The involvement of government in all of the nation's business is significant, and, no matter how much we may wish otherwise, it is likely to remain so. It seems certain that government involvement, at state and federal levels, will remain at a higher level in the telecommunications industry than it is for all of industry as an average. It may, however, become considerably less of a controlling influence than it is now. Specifically:

- A. The principles of accounting which are applied to industry generally, are applicable to telecommunications companies. Commissions need not, and should not, prescribe different rules.
- B. Depreciation rates are a responsibility of management, as are other expenses. They need not, and should not, be prescribed by regulatory commissions.
- C. Rules for the separation of investments and expenses among services must be prescribed (as they are today) by a federal agency.

D. Divisionalized accounting and separations rules provide adequate protection against improper pricing, and avoid the added costs of separate corporate structures. No carrier should be precluded from participation in any business.

E. The only extraordinary regulation needed in the terminal equipment market is that which concerns quality control; and a large part of that protection can be handled by the carriers themselves without harming other competitors.

F. There is a continuing need for regulation, at the state level, to limit entry and departure from the market for local exchange services, set the rates therefor, and define boundaries and service requirements.

G. There is an important role for state regulators in the setting of charges for intercity services for the support of local facilities, and in their distribution among local carriers. An arrangement for doing this can maintain a significant level of support if that is desired.

H. Intercity carriers, if free to set prices at will, would find themselves constrained by market conditions to a considerable degree. Pending more analysis of the subject by the intercity carriers themselves, a standby or appeal authority for a federal agency may be appropriate.

I. Except for accommodating access/availability charges, it is not apparent that present methods of division of revenues would have to change materially.

J. Association among the telephone carriers for the provision of joint through services could continue much as it is today, but other options are also available.

Given "deregulation" to the extent indicated above, we are now satisfied that a national telecommunications policy providing for competition to the degree contemplated in our earlier discussion paper can be made to work.

II. ACCOUNTING, DEPRECIATION, AND ORGANIZATIONAL ISSUES

A. Applicable rules of accounting

Present accounting rules have evolved in a regulatory environment, and are embodied in Part 31 of the Federal Communications Commission Uniform System of Accounts (USOA), which classifies revenues, expenses, assets and liabilities. All companies providing local exchange service are also regulated by state commissions, all of which have adopted, or at least recognize, the FCC USOA. Most state commissions, however, have maintained direct control over depreciation rates and other items not specifically covered in Part 31. Telephone companies, as publicly held corporations, are also subject to accounting rules and recommendations of the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC) and the American Institute of Certified Public Accountants (AICPA).

These multiple lines of authority have always presented potential problems, since they are not always in agreement. An addendum to Accounting Principles Board (APB) opinion number 2 was issued in 1962 in order to allow accounting requirements imposed by regulatory authorities to be recognized as if they were "generally accepted accounting principles (GAAP) for the regulated company."

Accounting guidelines have been developed and are in use for many industries and organizations, such as banking, savings and loan, health care, construction, colleges and universities, securities brokers and dealers, motion pictures, etc. A proposal has been made that the FASB appoint a task force to rewrite these existing industry guidelines which were issued originally by the AICPA. Guidelines for the telephone industry could be established also, under the jurisdiction of the FASB, which recently formed a task force to consider accounting issues related to regulated companies.

A Cost Accounting Standards Board (CASB) has developed rules and regulations for use in the administration of government contracts which could be applied to telephone companies operating in a competitive environment.

It is not desirable to have accounting rules which are applied in a competitive environment set by a government agency for some competitors and not for others. It is not necessary for accounting rules which are applied in a noncompetitive environment to be set by a regulatory agency, as expenses and investment can still be evaluated for rate-making purposes under FASB rules (GAAP), without distorting the companies' published accounting records.

In summary, there is already in existence a system of accounting standards adequate for the needs of a competitive telecommunications industry, quite apart from the jurisdiction over this subject which is now given to regulatory agencies.

B. Depreciation rules and practices

Telephone managements and regulatory agencies often disagree on an appropriate level of depreciation rates, causing telephone equipment, lives, on the average, to be longer than the depreciation lives used in other industries—even for equipment which is common to other industries. Most observers agree that present rates

are too low, but regulators are also subject to pressures to hold down the price of service, and have yet to recognize the need fully.

The determination of useful life and estimated salvage value, with or without regulation, is an exercise in judgment, influenced by market conditions, labor and capital costs, and technology. One cannot say that a truck, or a computer, has a specific useful life regardless of the industry, or location, or other conditions of its use. Accounting rules do require that the net assets (gross assets less depreciation reserve) be reflected accurately on the balance sheet, and that adequate disclosure be made to allow users of financial statements to review and consider the depreciation policies which are set by management.

Industry capital recovery practices are deeply rooted in historical analysis, but as the pace of change accelerates, historical facts become less reliable as an indicator of the future. A retrospective view to set future depreciation accruals cannot serve the needs of either the industry or its customers, but rather tends to delay the implementation of new technology and pass greater costs to future customers.

"Remaining life" is a method of calculating depreciation expenses that uses the current depreciation reserve in determining future accruals and thus assures full capital recovery. This method responds quickly to a changing environment by increasing or decreasing depreciation accruals based on the remaining life of each class of plant and the unrecovered capital in the associated account.

A change in switching technology, such as the current trend toward digital switching systems, requires accelerated retirement of older systems. This has been experienced in step-by-step systems, and is likely to be experienced soon in cross-bar systems. The use of electronic switching systems also provides other opportunities for cost and service advantages, and, at the same time, threatens to shorten the lives of terminal and transmission equipment. Technological advances in portions of the integrated telecommunications system affect the entire system, for whenever a major improvement occurs, the system as a whole has to be re-balanced to maximize system service and to minimize system cost.

Accordingly, depreciation rates should be examined and adjusted frequently to reflect the impact of technology and of market conditions, and to allow the accelerated replacement of technically and/or functionally obsolete equipment without penalizing future customers. This is unlikely to happen unless depreciation rates are established by management at its discretion, in conformance with GAAP, and made subject only to IRS limitations.

C. Divisions versus corporate subsidiaries

Under competitive conditions, it will be necessary for telephone companies to maintain accounting records on a segregated basis:

1. To maintain separation between regulated and the nonregulated telephone operations.

2. To maintain separation among various nonregulated operations, such as terminal equipment, intercity facilities, etc., for purposes of determining profitability.

The best approach would be to establish operating divisions within existing companies, as do many large corporations. General Motors' operations, for example, are set up by divisions representing the brands of automobiles manufactured by them. IBM, for example, has a Data Processing Division, a System Communications Division, a Systems Products Division, a Research Division, and an Office Products Division, among others.

Divisionalization requires allocations and assignments which are sometimes arbitrary, but it also has several advantages:

1. Financing is easier for a single large company than for several small companies.

2. Operating efficiency is often better. The ability to share overheads, maintenance staffs and sales offices may be the only economically feasible way for the local telephone company or anyone else to enter the terminal equipment market in small communities and rural areas. Otherwise, customer-owned terminal equipment in these areas could be dependent on catalog mail order sales or sales and maintenance from somewhat distant metropolitan areas.

3. Accounting efficiency is better as a result of having only one general ledger, filing one income tax return, one audit, etc.

4. If plant is reassigned or reused, it can be done by journal entries rather than by sales from one company to another.

5. Indenture problems are avoided because the capital structure of each company is maintained intact.

We can only conclude that it is in the public interest to obtain reasonable separation between competitive and noncompetitive services within a corporation through divisional accounting, and that there should be no requirement for the formation of separate corporations.

III. HOW A DEREGULATED TERMINAL MARKET MIGHT FUNCTION

The terminal equipment market is replete with participants attempting to penetrate the markets traditionally dominated by the telephone common carriers. In any competitive market there are success stories and failures, and the same can be expected in the terminal market. The manufacturers, distributors, and retailers are all seeking to establish their identities and products with the consumer. Eventually the consumer will determine who will remain in the marketplace.

The carriers have reacted to this new competition by placing more emphasis on meeting the needs of the consumer. Modular jack installations, Phone Shops, pick-up points, and business sales centers are some of the techniques being used to make shopping and comparison easier for the consumer. These same techniques also reduce the costs of terminal equipment sales by encouraging more customer participation when establishing, changing, or disconnecting service.

Part 68 of the FCC Rules and Regulations defines the consumer's right to own and connect terminal equipment to the telephone network as long as he is served by one-party service and connects only authorized equipment. The rules place several responsibilities on manufacturers, telephone companies, and consumers to ensure that the telephone network will be protected from certain types of harm that could occur as a result of connecting faulty terminal equipment. Part 68 gives the telephone company the right to disconnect service to customers who continue to use equipment which interferes with the proper functioning of the telephone network.

Part 68 is a step towards a deregulated terminal equipment market, partially opening the door to competition. Nonregulated purveyors of terminal equipment are free to enter markets, to exit from them, and to price and merchandise based on conditions in the marketplace, but this privilege has not been extended to the telephone common carriers who still face regulatory constraints in depreciation rates, profit margins, and tariff filing requirements for adding or deleting products.

Under competition, as long as the trade laws and anti-trust laws are not violated, the players in the marketplace should be free to pursue markets or respond to competitive challenges as required to accomplish their business goals without regulatory constraints.

A. Interface standards

Deregulation does not remove the need for technical standards and rules to protect the operational integrity of the network. There are many precedents for the participation of manufacturers, carriers and users in joint activity directed to agreement on interface standards, often under the auspices of trade associations or federal agencies.

The starting point for developing standards could be Part 68 of the FCC Rules, and practices of the Bell System and of the major Independent systems.

As new technology evolves, there will be offered new products and services, some of which may cause modifications to industry interface standards. Manufacturers will, in due course, reflect new requirements in their products, but customers purchasing terminal equipment preceding the change will be exposed to some risk, much as are the purchasers of other consumer products (i.e., TV recorders) which depend for their performance on the functioning of a larger system. This risk is present today, although not commonly acknowledged.

B. Quality control

Standards for quality control for both new and used equipment could be set by a federal agency, a trade association, an Underwriters' Laboratory, or by the telephone industry itself. Terminal products, new or used, should be "certified" as to quality, and companies selling uncertified equipment should be subject to fines levied by a federal agency which licenses certifying agents.

In the final analysis, the telephone company is the only entity which can be responsible for the quality of performance of the network. It has a natural incentive to prevent the connection of inferior terminal equipment to the network. (Indeed, this point has not been challenged. Most arguments have centered around the tendency of the telephone company to be too restrictive.) It should, therefore, only be necessary to assure that customers and manufacturers are not unfairly constrained from using or supplying terminal equipment of good quality which the telephone company doesn't "like," but for insufficient cause.

The most economical solution would be to provide that any brand and model of equipment offered by the telephone company is automatically certified no matter where obtained, and to permit (but not require) the telephone company to test and certify (or reject), for a fee, used equipment, and new equipment of "foreign" manufacture. It is only necessary, then, that a reasonable route of appeal be available to the user or manufacturer who does not accept the outcome of this test.

The volume of appeals should be small in relation to the market as a whole, and the overall economic cost would thus be minimized.

As the telephone companies begin expensing Account 232, Station Connections, the stage will be set for offering consumers additional options in home wiring for terminal equipment. Carriers may want to encourage competition in this area.

Installers could be licensed by the city or certified by the telephone company, and proper training could be provided by the telephone company or by trade schools. All wiring should be connected to the local network at the protector with a plug inserted into a telephone company-provided jack arrangement, to permit the customer to disconnect the premises wiring from the network when necessary.

An alternative approach to licensed installers would be an "installation wiring package" for the "do-it-yourself" customer. Such a kit would contain installation instructions, a number to call if trouble is encountered during the installation, and a test number to call when the installation is complete. The customer desiring help on an installation could be billed accordingly.

Telephone companies will wish to evaluate the merits of using subcontractors for residential premises wiring, at least in small exchanges. As more sophisticated terminal equipment becomes common, telephone companies may wish to specialize in certain wiring and leave the remainder for subcontractors. It is entirely possible that some carriers will choose to abandon residential premises wiring altogether, at least in some communities.

On-site repair of residential telephone instruments is very expensive and relatively unproductive. It is likely that a deregulated environment would result, eventually, in repairs of residential telephone instruments taking place only at centralized repair centers where the customer delivers and retrieves the telephone instrument. Most carriers can be expected to repair all instruments of the same make and model as those they provide, for a fee, regardless of where the instrument was purchased.

Because of the probability that disputes will arise as a result of service disconnections, the application of service charges or disputed quality-control inspections, an appeal process should be available to the consumer. This would best be handled by the state regulatory agency responsible for local service standards.

C. Service areas

As part of the transition process, a telephone company must evaluate each market in which it wants to participate, perhaps including those for products and services that have not been traditional telephone company offerings. Distributorship arrangements will probably evolve, whereby the unregulated divisions of local telephone companies will market products for vendors that could not otherwise afford to reach some communities. Some of these products may be only remotely related to traditional communications.

The transition period will be a time for aligning marketing organizations with the marketplace. Some companies may find that franchise boundaries do not provide for efficient marketing territories, especially when customers have multiple offices or branches, or are part of a retail chain. In fact, franchise boundaries, important as they are to local exchange service, are likely to become irrelevant to the market for terminal equipment. Conflicts will develop which are new to telephone companies, but which are quite ordinary in competitive business.

In some locations, there may be an economic incentive for the local service division of a carrier to get completely out of the terminal equipment business, or the terminal repair business. Probably there should be some restraints, at least during the transition period, if no other supplier were present, but this problem—if it develops—should be handled at the state level. The local service division of a telephone company could be required to furnish some basic terminal equipment to small communities, but the local service company would need to be free to establish appropriate depreciation rates and pricing options that ensure capital recovery.

In order to avoid the disruption that could occur if deregulation were thrust on the terminal market suddenly, the following is offered for consideration:

1. During a transition period, the local service division of the common carrier would continue to be the supplier of last resort for terminal equipment. The carrier would have the prerogative of selecting the instruments and equipment to be sold and leased, the level of depreciation rates, and the pricing options to be offered to the consumer. State regulators would ensure that the activity does not burden the local service rates by monitoring costs and revenues. In a rate determination hearing, the state regulators might disallow costs, if such costs were not charged according to the cost accounting guidelines established for the industry.

2. The carrier would retain the existing "rental" customer base under grandfathered tariffs during the transition period, subject to rate increases as might be authorized. PBX customers would continue to be "lease" customers until their

termination contracts expire. PBX and Key System customers would be given an opportunity to purchase in-place equipment.

3. Prior to the end of the transition period, non-intelligent telephone instruments might be offered by some companies on an outright sale basis only, thus avoiding an inventory build up of used equipment, or of new but obsolete instruments.

4. Intelligent terminals might be provided on an outright sale basis or through a tiered contract that assures capital recovery.

5. Repair service on residential and single-line business customers might be performed at centralized locations only. If a repair visit were required, it would be priced to reflect costs of the trip.

6. At the end of the transition period, existing business equipment that had been grandfathered would be transferred to an unregulated division. The remaining terminal equipment (grandfathered residential customer base) would remain in the regulated division until subsequently written off through depreciation charges or outright sale.

7. All new purchases of terminal equipment and devices used on the customer premises, and the associated expenses, would be recorded on the unregulated division's books beginning with the date on which existing terminal equipment tariffs are grandfathered.

8. The unregulated division should be free of regulatory restraints, other than fair-trade laws, in the area of market entry, abandonment, pricing, organization, and accounting so long as such activities do not burden the local service (regulated) division.

9. Challenges to the carrier in the areas of predatory pricing, unfair competition, restraint of trade, etc., should be made through the courts rather than through a regulatory agency, as is the case with other businesses.

The transitional conditions described above presume that local telephone companies will find it advantageous to abandon the conventional rental terminal market, with all maintenance included. Some may choose another course, and they should not be prevented from doing so.

IV. HOW THE REGULATED LOCAL MARKET MIGHT FUNCTION

A. Jurisdiction

The concept of unregulated, or federally regulated, intercity services solves a problem of long standing, known commonly as "toll rate disparity"—i.e., substantially different prices for toll calls of essentially the same distance, one crossing a state line and the other wholly within one state. At the same time, moving the jurisdictional boundary from the state line to the community limits creates its own set of problems.

Viewed from another perspective, however, the problem is not "created"—it is already there. Metropolitan areas present difficult economic problems, and community-of-interest problems, to which EAS and metro-plan are only partially successful solutions. It is not proposed herein that these problems be removed from the purview of state regulation.

The Communications Act of 1934 defines "Telephone exchange service" as follows:

* * * service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange and which is covered by the exchange service charge.

Among the more important virtues of this definition is its longevity, and the confidence in legal proceedings which goes with that attribute.

The bill, H.R. 13015, proposed as The Communications Act of 1978, retained this definition essentially unchanged.

Were there a general agreement among regulators that the proposed jurisdictional boundary is proper, it would be easy to administer with this definition. On the other hand, were a state commission motivated to enlarge its scope of authority, and thus frustrate the objectives of the proposed legislation, then conceivably, it might declare as an exchange some area which does not, by conventional standards, come close to our current understanding of that term. One need only move away from any large and growing city, observing the residential, commercial and industrial development as one goes outward from the city's central core, to find an example of a borderline case to which this or any other definition could be difficult to apply—if anyone chooses to make it difficult.

It would be a great convenience to avoid such problems, but alternative definitions seem only to move the problem around.

State lines, franchise boundaries, base rate areas and the like, always present this type of problem eventually, except perhaps where the land meets the ocean. It is preferable to make clear our intent and to leave the application to case-by-case

review, rather than to attempt a universal resolution to a problem having an infinite number of forms.

Metro areas grow gradually, and the community interest changes accordingly. State commissions are, in general, in a better position to deal with these needs than is a federal agency. The factors which make a noncompetitive environment more attractive within an exchange also apply, in varying degrees, to the fringes of metro areas. The same considerations which argue for a general reliance on market forces rather than market allocations by government fiat, also argue against rigid definitions of market segments. The pressures of particular circumstances can and should determine specific conclusions.

Since it is our intent to leave local problems to local solution, and yet to foreclose any encroachment on what we know as "toll service," we propose the following definition of telephone exchange service:

"Telephone exchange service" means voice grade service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by a single exchange service charge and/or a variable charge or rate based upon time (but not distance).

B. Authority

After the jurisdictional boundary has been identified, there remains the issue of the extent of state commission authority within that boundary. States have authority, not by *delegation* from the federal government, but as defined by their own constitutions, except for matters which are *preempted* by the federal government. Thus we need not, and cannot, specify the full extent of their authority. For our purposes, it is necessary only to specify certain things that they must be precluded from doing, and to suggest guidelines for the conduct of regulatory affairs.

All parts of the integrated telephone network are of concern to the functioning of the whole. Therefore, the use of the network, including the interconnection with it of such terminal devices as may be useful to the public, should be constrained only by technical considerations which have, as their objective, the assurance that the network will function properly for everyone.

Since the national telecommunications policy is here assumed to favor a competitive environment, any exception to that pattern should be identified as deliberate. State regulation is properly concerned with assuring the availability of telephone service of good quality at reasonable prices. These results are of national concern, too, but their achievement under varying local conditions can best be encouraged by regulation close to the local environment.

With respect to availability, state commissions should control, to the extent provided by state law, market entry and withdrawal—which, in practice, means franchised territory and the obligation to serve areas which are economically unattractive in return for the assurance of a fair overall rate of return.

With respect to quality (which is a necessary corollary to availability), state commissions should provide a route of appeal for the consumer, where, if necessary, penalties can be imposed for poor management performance. Standards of performance can, of course, be set at the discretion of the commissions.

With respect to prices, state commissions have, and should retain, their most sensitive and compelling function, which will be discussed at greater length below.

There is no need for state commissions to have any additional authority beyond access to relevant information and enforcement powers. In practice, commissions now exercise more authority, usually encompassing such matters as financing, accounting, depreciation rates, and administrative procedures. It is unlikely that they can be prevented by legislation from needless interference in the management of companies, but perhaps they can be encouraged to rely upon market rewards and penalties to the maximum possible extent.

Companies which provide other telecommunications services in addition to local exchange service will operate in a competitive environment. It is important to the objectives of national policy that these companies not be restrained from effective participation in these other markets by any action of state commissions which is directed at their performance of obligations in a noncompetitive market. Federal laws can preclude such interference. For example, it would be desirable to require that the revenues, costs and investment associated with unregulated activities of a local common carrier not be considered in the determination of reasonable rates for the regulated services provided by that carrier. To permit otherwise would be to make possible a coercive force acting in restraint of trade.

In that section of the Act which reserves to the states the authority to regulate "telephone exchange service" there could be provisions which define certain actions as contrary to the promotion of trade and commerce, such as, for example, the

requirement for accounting procedures which are contrary to "generally accepted accounting principles," or the requirement for depreciation rates, or treatment of tax deferrals, in ways contrary to IRS (of other) guidelines for industry generally.

These suggested restraints on commission authority should not be construed so as to impair their ability to judge the reasonableness of rates. Commissions must be free to obtain all relevant facts, and to accept or reject expenses and plant values for rate-making purposes, subject to the usual laws against confiscation.

C. Ratemaking

Most rate-making functions of state commissions, apart from intrastate toll rates, need not change in order to implement the suggested policy, except for their involvement in the determination and distribution of availability and access charges, which will be discussed in section V. Even though not essential, however, it is desirable that procedures be changed so as to utilize market forces where they can be applied to achieve the same overall objectives which are the goals of present procedures.

The most useful departure from present procedures would be to simplify the process by which a "reasonable rate of return" is defined. A worthwhile objective would be to identify one or more national economic statistics to which could be "pegged" lower and upper limits of "reasonable rate of return." The time and cost of state rate-making proceedings could then be devoted to more fundamental issues, such as:

1. Does the performance of the company in terms of quality of service, efficiency, and public satisfaction, merit an earnings level near the top or the bottom of the "reasonable" range?
2. How should the cost and value of service be distributed by the rate structure among classes of service and locations of customers?
3. What should be this company's share of the pool of availability/access charges? (See section V)

Such an approach to rate-making would give more attention to those matters which directly affect customers, and less to repetitive and largely academic debates which are rarely of real significance to the public. It would save time and money—company money, tax money, and consumer money. It would also utilize economic forces in the marketplace to reward efficiency and penalize poor management performance—imperfectly, to be sure, but to a greater extent than does current practice.

Such procedures cannot be legislated at the federal level. They could be encouraged, however, by charging a federal agency with the development and publication of guidelines. These would have the effect of making compliance the "easy" and less risky route, in case of appeal. It is worth trying.

V. ACCESS/AVAILABILITY CHARGES

Access/Availability (A/A) charges will be paid by all intercity carriers—telephone, "special," and "other"—who depend upon the facilities of local carriers for the viability of their businesses. Such charges have at least three separately identifiable functions.

A. To recompense the local carriers for costs incurred in the provision of local facilities used for receipt and delivery of intercity traffic.

B. To make a contribution toward the local rate structure in support of the universal availability of telephone service which adds value (i.e., the ability to reach almost any household or business in the modern world) to most, if not all, intercity services.

C. To encourage efficient development and utilization of shared, common switched networks in the interest of lowest total cost of all users of such networks.

Legislation should provide for and assign the authority for the determination of A/A charges, including the allocation of costs among various uses for shared facilities. It should provide guidance, at least through statements of policy and possibly in more specific ways, to those who will determine the level of support to the local rate structure and to those who will make the value judgments required to encourage the efficient development of networks. And, finally, it should assign authority for determining how A/A charges, for all of these purposes, will be apportioned among the local carriers in the public interest.

Determination of costs

Certain elements of the telephone plant have only a single purpose, and their costs are easily identified with a single service. These, however, are few in number, and as new services proliferate they may eventually disappear altogether. Most elements of the plant serve at least two broad classifications of services—local and intercity—and some, such as distribution cable, for example, hold the potential for

providing great numbers of services, including some which are not commonly classified even as communications.

In order to identify a cost-to-service, the costs of commonly used plant, like overhead costs in every business, must be assigned or allocated. It is easy to describe general principles for allocation—or “separation,” as it is commonly called in the telephone business, referring originally to jurisdictional issues—but in the final analysis, arbitrary decisions are always required. These decisions cannot be defended as right, but only as reasonable under the conditions existing at the time they are made.

In many, if not most businesses, overhead allocations are of real concern only to the owners and managers who make decisions about the allocation of resources. In telecommunications, because the figures involved are very much larger, and because all elements of the public are affected, allocation rules have had, and will continue to have, great importance. They must, therefore, be defined and used uniformly by all carriers and by all regulators. Carriers and regulators have great stakes in such decisions, and should participate in them, but uniformity can be achieved only by assigning final authority to a federal agency.

The preparation of allocation, or separation rules is the first step in the determination of A/A charges. These rules will define costs, which then must be measured, company-by-company. (While this sounds complicated, the same process goes on today as a normal part of the rate-making process. Every large telephone company, and many small ones, knows its “costs” as they are now defined for ratemaking and settlements purposes.) Decisions must then be made about aggregating these costs. They could be put all together for calculation of a national average, or they could be grouped regionally, or by states, or by parts of states, depending on national objectives concerning the uniformity of telecommunication prices.

It is not necessary that a decision be made in advance. It is preferable, rather, that such decisions be reviewed periodically, and so we need only be concerned with the process of decision. Similarly, we need not be concerned, here, with the structure of cost formulas, having fixed and variable components, partly sensitive to usage and partly insensitive, etc. It is necessary only to acknowledge that these matters are fairly complex, that they should be dealt with by experts, and that all carriers and regulators should participate, directly or through representation.

Determination of support levels

Wide variations in the support given the local rate structure from intercity services can be defended as reasonable. At one extreme, perhaps, is the concept that local plant is required for, and should be paid for by local exchange services, with only incremental costs for intercity traffic being added. At the other extreme, it can be argued with equal reasonableness that intercity services require nearly every component of “local” facilities, and should pay for all of it except the added quantity required for the volume of local traffic. It is difficult to say exactly what is the current level of support, but it is widely believed to be on the order of 30%. We take the position that it should be maintained at about its present level through a transition period, after which it should change in small increments as market pressures and public policy dictate—or as they are compromised in a public forum.

The carriers know, or will know, about market pressures. State regulators and local carriers have a great stake in the determination of public policy, as it will determine the level of local telephone rates. The number and variety of parochial interests is so large that a federal oversight role seems essential. Legislation should provide only broad guidelines on the level of support, such as, for example, providing that large changes should be made only after full hearings and opportunity for negotiation among all interested parties.

The level of A/A charges above directly identifiable costs—i.e., those charges which result from arbitrary allocations and from the support payments discussed above—has an important effect upon the efficient utilization of resources. This is simple to explain conceptually (see Appendix A) but very difficult to deal with in quantifiable terms. Simply stated, the level of A/A charges and the structure of intercity rates will influence how much business is offered to switched common-user networks, how much to private-line direct connections, and how much to newly developed distribution systems which bypass existing local facilities entirely. These decisions, in turn, will influence the prices charged to users who stay on switched common-user networks, and also the total national investment in communications facilities, some of which will be redundant.

All of the factors involved here are, essentially, value judgments, which, in economic theory, can be made most efficiently through negotiations and buy-sell decisions in a free-market environment. Since we are not dealing in a totally free market—the local market is regulated, and A/A charges will be set with regulator participation, and perhaps final authority in a federal agency—these value judg-

ments will have to be based in commission proceedings. For our purposes it is necessary only that federal law acknowledge the relevance of value of service in the setting of A/A charges, and direct that this consideration be taken into account in the interest of an efficient national telecommunications system.

Ideally, value of service can be used to promote efficiency by the use of complex measured-service rate structures which encourage full loading of switched network systems at all hours of the day. At the other extreme, flat-rate structures encourage the construction of direct facilities on all high-density routes, leaving only peak-hour overflow loads and low-usage services on the common-user network. (See Appendix A) Since complex rate structures are difficult to devise and administer, and have marketing disadvantages as well, many compromises are to be expected. Also, since universal metering is expensive, and the equipment not widely available, some temporary expedients may be necessary.

While rate structures and metering capabilities are being developed, a strong case can be made for assessing A/A charges against all intercity services, at some level—even those which make no direct use of local carrier facilities, as long as the type of communications carried is compatible with, and thus could use, the local carriers' facilities. At the very least, the use of declining rate schedules which induce high volume customers to remain on the network should be permitted under the law and be encouraged by the A/A charge structure. Such discrimination in rates is not contrary to the interests of low volume customers. As shown in the numerical example in Appendix A, when an effort was made to charge the same for all minutes, some subscribers left the network, driving the price up to remaining subscribers. When a discount was allowed for heavy traffic routes, the price to remaining subscribers fell.

In those locations where measured rates are offered today, local measurement does not apply to toll calls. There is no conceptual reason, however, why such measurement could not supplement an access charge. In fact, value of service considerations may suggest that the local measured rate be higher for intercity calls than it is for local calling.

In a fully measured environment, the intercity company could be treated just as any other local subscriber. When intercity calls are terminated in the local exchange, the connecting company could be billed just as if it had originated those calls locally, and according to the same rate schedule (including time-of-day and volume discounts, etc., as applicable) which is applied to every other local subscriber.

Measured rates, however, are not a panacea for the pricing problems of the telephone industry. Subscribers with concentrated point-to-point calling demands may be induced by measures rates to substitute direct connection for use of the local distribution system. Measured rates are quite likely to result in an abundance of such competitive substitutes and alternatives to the local switched network—each reflecting excess capacity and duplicated facilities.

As was suggested earlier, the multitude of potentially conflicting interests in the level of A/A charges suggests that an important government role is unavoidable. However, to be consistent with the philosophy of this proposed legislation, market forces should dominate, and freely negotiated contracts are preferable to rate-making by government agencies.

In the past when regulatory matters transcend federal and state jurisdictional boundaries, it has been common to convene a Joint Board composed of federal and state commission representatives. The results have not always satisfied all parties—or any parties—but the procedure exists. It might be improved, expanded or supplemented for these purposes.

A Joint Board could (1) accept recommendations from intercity and local carriers (such recommendations might be offered individually or collectively by the carriers), and (2) after considering these recommendations, offer its own recommendation to a federal commission. The federal commission would then make a final determination. This Joint Board might be convened at any time, but should be scheduled to meet at regular intervals.

A Joint Board must first determine an aggregate amount of revenues to be derived from A/A charges, and thereafter select a schedule of A/A charges designed to achieve this revenue requirement. Competition in the intercity market forces a conscious determination of the amount of toll support of local plant costs. It would be reasonable, however, to take present levels of support as a starting point. The Board might be empowered (subject, as always, to federal approval) to separate the property and expense of the local operating company between (1) those costs which are exclusively used for intercity telecommunications, (2) the usage sensitive costs of local exchange incurred in support of intercity service, and (3) the usage insensitive costs of the local exchange which are to be attributed to intercity service. The

amounts in (2) and (3) would become the revenue requirement to be recovered by access and availability charges. The Board must, of course, be permitted the power to collect from the carriers that data which is necessary for performing these separations.

This revenue requirement could be determined conceptually for each individual exchange, or aggregated by company, region or state, or even nationally. Regional or statewide aggregation appears to hold important advantages. Compared to exchange or company aggregation, fewer schedules of access and availability charges would be established, thereby reducing the complexity of the intercity rate structure. Regional, as opposed to nationwide, aggregation permits some degree of cost variation to be acknowledged by the rates. The Joint Board could be empowered to determine the boundaries of these regions based upon observed regional cost variations. For practical convenience, the smallest unit should be no less than a Number Plan Area (NPA).

Once regional boundaries are defined, the Joint Board must propose a schedule of access and availability charges to recover the aggregate revenue requirements. The Board should be directed to treat all intercity carriers equitably and to give full consideration to the possible effects of its decision upon the use of competitive alternatives and resulting excess capacity.

Distribution of revenues

If access and availability charges are determined regionally, the A/A revenues attributed to the intercity traffic originated and terminated by one company will not match up with that company's A/A costs as defined by the Joint Board separations. For this reason, it is desirable that A/A revenues be regionally pooled and redistributed regionally rather than being directly remitted by the intercity carrier to the local operating companies with which it connects. Such regional pooling and redistribution will promote universality of telecommunications service. Local operating companies might be allowed to administer the distribution of pooled revenues subject to the oversight and final authority of the appropriate state regulatory commission. For instance, local carriers might agree to distribute the funds according to the property and expenses allocated to the pool by separations formulas. An example of how access charges revenues might be pooled and distributed is contained in Appendix B.

VI. HOW THE INTERCITY MARKET MIGHT FUNCTION WITH DIMINISHED REGULATION GENERAL

A large portion of the intercity telecommunications market between major metropolitan areas is now the target of specialized communication companies that are competing head-on with the Bell System and the Independent telephone industry. By electing to serve only the most profitable routes, the specialized carriers are able to price services considerably below the average prices for similar services provided by the telephone common carriers.

All major industries face some restraints on their operations—i.e., truth in advertising, product warranties, use of hazardous materials, pollution, discriminatory pricing, etc. In general, however, in competitive industries managers enter and withdraw from markets, and change products, services and prices, based upon economic judgement. These prerogatives are not available to the telephone industry today. As a result, markets are being divided by regulatory decisions, under the guise of "competition." While customer choice is involved, it is not a choice among truly competitive alternatives.

If competition is to prevail for intercity communications services, there should be increased reliance upon free market forces and a diminished reliance upon regulatory commissions for determining what communications services will be available at what prices. Removal of the intercity market from the control of a federal agency will free carriers from the constraints that prevent timely responses to the demands of the marketplace. It will not however, eliminate the application of restraints which apply to all business generally, nor will it remove the need for a federal agency to "referee" negotiations, accept appeals, and establish certain rules which ensure the ongoing viability and integrity of the nationwide intercity switched network.

Among the tasks of the federal agency would be these:

1. Complete authority over allocation of the frequency spectrum.
2. Complete authority over satellite orbit slots.
3. Review authority over technical interface standards.
4. Appointment of certifying agencies for terminal equipment.
5. Final authority for separations rules.
6. Oversight of negotiations among carriers for management of the network, rules for interconnection, and the establishment of joint through services.

7. Oversight of negotiations among carriers and state commissions, with final decision authority, for setting and disposition of availability/access charges.

8. Acceptance of grievances and appeals concerning intercity carrier services for investigation and negotiation with the carriers.

9. Recommendations to the Congress concerning national telecommunications policy.

In some of these functions, state commissions should play an important role, probably through joint board proceedings.

The federal agency would not perform traditional functions of the FCC, such as approving rate structures, depreciation rates, accounting rules, and facilities construction (except radio transmitting stations).

Pricing of intercity services

The evolution of a new price structure would begin from present conditions and practices. (For simplicity, we will put off consideration of Independent telephone companies, and will treat the telephone system as if it were operated completely by AT&T.) The salient characteristics of present procedures are:

1. A carrier proposes to the FCC a service and a price. If the service is competitive, then other carriers object. The FCC decides if the service is to be offered, and eventually approves a price.

2. Billing offices of the carrier collect charges from users of the service, which are then divided among the participants (if joint through services are involved), or accounted for according to whatever accounting practices may have been authorized.

3. In the case of joint through services, costs of each participant are recovered (if revenues are adequate for the purpose) and profits or losses are shared by contractual agreement.

4. If one or more participants offer several services to the public, then the costs of each service are defined according to rules issued by the FCC.

(We may note in passing that the participation of an Independent telephone company in a joint through service adds only the requirement for agreement among the participating carriers on the price, the place and manner of interconnection, and administrative procedures for billing, division of revenue, etc.)

Long distance telephone charges follow a uniform pattern which would be difficult to abandon, even if there were a desire to do so, because of the mass market. Instead, under the arrangements here proposed, the pattern would remain and exceptions would be made where market conditions warrant.

1. A carrier would establish a new price for a particular service or route, within constraints of federal law concerning unreasonable discrimination, with just enough public notice to satisfy practical marketing needs.

2. Billing arrangements would remain unchanged as long as participants in joint through services remained in agreement.

3. Settlement arrangements would have to accommodate availability/access charges, which would, presumably, go into separate pools. Otherwise, present patterns for division of revenue would be applicable.

4. Separations rules, from a federal source, would still be required.

It is possible to speculate on what rate changes would be made, and on what the effects would be. We have no facts upon which to base a forecast, and have some doubt that anything short of an actual trial would justify a conclusion. Surely some price reductions would be made along high-density routes, and a lot of new software would be needed to handle a more complex rate structure. Perhaps, in sparsely settled regions, prices would be increased. Perhaps, if they were, they would "stick", and maybe they would not. (Theories which have been advanced about price/demand elasticity in the telephone business do not have a great record of credibility.)

To keep these matters in perspective, it is helpful to remember that long distance telephone service is a relatively low-priced, high-volume business, so that a few cents per unit has a large economic effect.

Two possibilities probably merit concern: (1) On low-density routes where competition does not develop immediately, telephone carriers might raise prices as much "as the traffic will bear"; and (2) On very low-density routes, where costs cannot be recovered, telephone carriers might withdraw from the market. Anything which could be said now borders on speculation, so we will leave these extreme possibilities for future discussion—after noting that a case can be made that either action would be foolish, both economically and politically. Probably the law should provide some recourse in the event that a trend should develop which suggests either eventuality.

We must say a word now about a simplifying assumption made earlier. Does the participation of Independent telephone companies complicate the picture? Not

really. As noted earlier, if participating carriers agree on rates (and on other operational matters which are unchanged by this proposal), corporate affiliation makes no more difference that it does today. Disagreement about rates for joint through services is possible, independently of corporate affiliation, but is perhaps more likely to occur when a small company is faced with higher costs than its "partner" and has no large base over which to spread them—i.e., cannot, practically, average them with other business.

If the partners pool billings (above the A/A charge level) and share profits there may be no incentive for one of them to insist on a higher price than the other is willing to charge. The "uniform" rate pattern may be modified to recognize higher cost regions; it is unlikely to be modified to recognize a high-cost small company. It is more likely that such a company will be supported by its "partner" (connecting carrier), just as it is today, in the interest of marketing policy.

Still, a disagreement may occur; an isolated exception price may be charged. There are at least two ways to deal with such a situation:

1. A carrier may place a surcharge on all traffic originating in its territory (or even on terminating traffic also), which would not be pooled.
2. The regional carrier/commission group could agree that economic support is justified and provide it through the A/A pool.

Of course, as a last resort, an appeal route to a federal agency could be provided for in the law. It would be well to find out, first, if the need is real or only imagined.

Another possibility to be considered is that a local carrier might choose not to concur in any other carrier's price structure, but instead contract with one or more intercity carriers to deliver and receive traffic. Here, we visualize that certain local carriers may elect to forego the revenues that would flow from the national settlements pool, and also from their regional A/A pools, and derive all revenues for intercity service from their own A/A charges and contractual agreements. If such an election carried the approval of the cognizant state regulatory body, and the level of A/A charges were also approved by that body, the practice appears workable, at least in theory.

The full effect of the practice, and also its appeal to any particular carrier, will depend on the range of costs which are encountered, and on the formula for distribution from the A/A pool.

VII. COMPETITIVE AND COOPERATIVE RELATIONSHIPS

A. Market entry and withdrawal

We submit that common carriers should be free to enter or withdraw from any competitive market. A carrier's status as the regulated sole-source provider of local telephone service should not serve as a barrier to that carrier's activities in other markets. Market foreclosure is the bane of competition; the advantages attributed to competitive activity are predicated in large measure upon the ability of all firms to enter the market.

Two arguments are commonly advanced in opposition to the carrier's freedom to enter and withdraw from other markets. (1) Carrier participation in competitive markets may result in cross-subsidization to the detriment of competing firms, and (2) In newly competitive markets which have been served traditionally by common carriers, the necessary obligation to be a provider of last resort falls logically upon the carrier.

(1) Cross-subsidization

Cross-subsidization is always a possibility whenever a firm is vertically integrated or produces more than one product. Successful proscription against cross-subsidization requires an adequate division of accounts among product lines and between regulated and unregulated activities. Standards for such a division may be derived outside the political process by accounting professionals. State regulators may, of course, make adjustments in these accounts for rate-making purposes, accepting the burden to show that these adjustments are necessary and reasonable.

The problem of vertical or affiliated interests is not new. Many telephone companies currently procure equipment, data processing, management consulting services, etc., from affiliated enterprises. The regulatory and judicial processes are charged with assuring that the prices paid for these goods and services are not excessive, and that unreasonable preference is not allowed the affiliate vis-a-vis alternative suppliers. Conversely, these same processes may ascertain that the carrier's charges for transmission and distribution are compensatory and do not discriminate in favor of the carrier's affiliated interests.

A special difficulty arises when the carrier adapts conventional telephone plant to other uses which are not regulated, e.g., meter reading, security, and alarm. One would not wish for legislation to prohibit—nor regulation to inhibit—the innovative

and efficient use of communications technology. The adaption (rather than merely "use") of telephone plant to new uses, however, will increase the costs of non-traffic-sensitive, jointly used distribution plant. The prevention of cross-subsidization requires, therefore, some division of separation of this jointly used plant. Numerous methods for allocating local distribution costs among services have previously been proposed, e.g., fully distributed costs, long run incremental costs, and apportionment based upon relative use. Each methodology is arbitrary and therefore the debate is hotly contested. Legislation should deal with this problem by assigning final responsibility for allocated costs. For example, this authority may be granted to a federal agency, a state agency, or to the accounting profession. This problem is not avoided simply by subjecting all such services to regulation.

(2) Supplier of last resort

Food, clothing, and shelter are three broad categories of goods which are generally considered to be basic, necessary, or essential. In each instance, the goods are produced and supplied by competitive industries. In each instance, "social problems" arise in that certain individuals cannot afford adequate quantities of these goods at competitive prices. Society has responded to this problem by providing direct support and assistance to needy individuals. There has never been a serious proposal to have a private enterprise assume an obligation to act as provider of last resort in these industries.

In fact, a provider of last resort cannot be viable within the competitive marketplace. Such an obligation implies that goods will be sold to some individuals at prices below cost, for otherwise these goods would be supplied voluntarily. If a firm is to remain normally profitable while nevertheless selling some goods below cost, other goods must be sold at prices greater than costs. This latter possibility is precluded by the rigors of competition. For this reason, the obligation to serve has traditionally gone hand-in-hand with franchised monopoly privilege—granted, protected, and regulated by government.

Severe social problems regarding the availability of competitive telecommunications services are, perhaps, a remote possibility. In the event such issues arise, however, two viable solutions are available. (1) The government may provide support directly, acting in essence as a supplier of last resort, and (2) Competition may be dismantled, substituting franchised territory to firms while requiring the obligation to serve. In the abstract, or in extreme circumstances, competition and the obligation to serve are not mutually consistent. We may, therefore, have to choose between one and the other.

We are not greatly concerned, however, with abstract theory, and actual circumstances may not turn out to be extreme. In competitive enterprise, distributors supply many outlets at more or less than their average profit margin, and some outlets below cost in order to encourage universal use, or to maintain a customer relationship and an image, associated with a common price. Telephone service is not directly comparable to what, years ago, was the universally available "nickel candy bar," but similar marketing considerations do apply to some extent.

We would be wise not to solve a problem with difficult or complex remedies until we are sure the problem really exists. Perhaps legislation should provide for oversight responsibility and contingency authority.

B. Joint routes, services, and facilities

The ownership of facilities which comprise the existing intercity network is fragmented among many companies. Although the Bell operating companies and AT&T Long Lines predominate, especially in the ownership of long-haul facilities, the contribution of the Independent telephone companies is not insignificant. A typical intercity call traverses the facilities of more than one company.

Fragmented ownership of intercity facilities implies that companies must make agreements to accept and transfer communications traffic if the network is to be economically integrated. Such agreement requires "association" or cooperation. These agreements would necessarily involve terms of compensation (division of revenue), establishing through routes, and technical and operating requirements for connecting companies.

One form of agreement is the contract. Contracts vary in scope and complexity, but as a general rule a contract will assign to one party the obligation to plan the network and accept the operating risks. An alternative form of agreement is the joint venture or partnership. Decisions relating to routes, prices, technical standards, and management of the network would be made jointly by all partners to the venture. (Of course, it is reasonable to expect that relatively small partners may have a relatively minor voice in this process.) Revenues from the joint venture could be pooled and distributed among partners in order to reimburse each for actual expenses and to yield a common rate of return on invested capital.

The desirability of maintaining Bell-Independent intercity facilities as a viable and integrated nationwide switched network is obvious. At issue is the need for explicit controls and regulation designed to restrain anticompetitive behavior by this large—and loose—consortium. Currently these controls are provided by federal regulation. Regulation, however, results in undesirable side effects, including the inhibition of normal and efficient response to market incentives in changing circumstances. Because it often protects an industry from antitrust laws and other statutes which would otherwise apply, regulation has even been observed to promote monopoly where it is not in the public interest. The alternative to regulation is to rely upon renewed and diligent antitrust and fair-trade oversight as restraints on anticompetitive or abusive activity.

A consideration of the potential role of antitrust litigation in a deregulated intercity market leads to two difficult questions. First, do the antitrust statutes provide sufficient restraint against monopolistic and predatory practices? This question, particularly in reference to pricing, is addressed in the next section. Second, absent the shield of regulation, would antitrust enforcement facilitate the continuing operation of a national network with shared or integrated ownership? Without specific immunity, the answer to this question is probably “no.” Although there is a growing number of competitors, the Bell-Independent network—or even the Bell System alone—maintains such a large share of the total intercity market as to make likely the conclusion that there exists a *de facto* monopoly in violation of the Sherman Act.

In the event of lessened regulation, it is therefore desirable to afford a certain degree of antitrust immunity in order to assure the continuing viability of the national network. (A “Carriers’ Carrier” is one viable alternative.) Legislation could specify the ability of franchised local carriers to combine or associate with an intercity carrier (AT&T Long Lines, MCI, SPC, etc.) for the purpose of creating, maintaining, and managing an intercity network. Such an association would not, by virtue of its organization, structure, size or market share, be construed to be a monopoly in violation of the antitrust laws. This immunity need not and should not extend to actions which, if taken by a single entity, would violate the law. The legislation must also make clear the obligation of all local carriers to provide interconnection with the local exchange to all carriers, associated or not, on terms which are not discriminatory.

C. Pricing constraints

The fundamental issue is not whether the pricing of telecommunications services (other than basic local service) will be constrained, but, rather, whether this constraint should be provided by regulation or by traditional enforcement of the antitrust laws. Either vehicle of constraint could prevent two sorts of pricing abuse: (1) Prices established above cost by a firm with substantial market power and (2) Predatory prices, i.e., temporary selling at prices below costs for the purposes of deterring or driving out competitors. It is perhaps ironic that this latter abuse has captured the public debate since, if consumers are in fact to be harmed by predatory pricing, it is precisely because this condition is only temporary and leads eventually to increased monopoly power and prices above costs as in (1).

The essential difference between regulatory and antitrust prevention of predatory pricing revolves around the burden of proof. In unregulated industries, the burden of proof is borne by the plaintiff—the government or a civil litigant. This burden may be substantial, since a firm may reduce its prices for a variety of reasons which are not predatory, e.g., because of enhanced competition, changes in cost, or changes in demand: “It would certainly be incorrect to describe an established firm as a predatory simply on the basis of a record that it had reduced the price of its product and then raises it when a rival withdrew or came to terms with it. Any attempt to define predation in this way and to brand it as illegal would make it virtually impossible for an established firm with a large share of the market to compete effectively with smaller firms or new entrants.” (B. S. Yamey, *Journal of Law and Economics*, April 1972.)

Economic observers have stated that predatory pricing is an inefficient method of attaining monopoly power, and therefore unlikely to occur. In fact, there is a dearth of documented examples. Some studies have concluded that predatory pricing was absent even in a number of instances in which antitrust remedies were successfully pursued.¹ For this reason, many legal and economic observers have concluded that the law against predatory pricing has more often than not been employed in a manner which was anticompetitive, namely, it was used to protect one firm from

¹ John S. McGee, *Predatory Price Cutting: The Standard Oil (NJ) Case*, *Journal of Law and Economics*, October 1952.

the price competition of another, thereby depriving the public of the benefits of enhanced competition and (permanently) lower prices.

Regulatory constraint on pricing transfers to the firm the burden of proving that its prices are not predatory. The predictable result is that price competition is inhibited to an even greater extent than it would be under the antitrust laws. Regulation retards the ability of firms, especially large firms, to pass on to consumers the advantages of their cost-saving economies in the form of lower prices.

Neither regulation nor litigation provides a perfect constraint against predatory pricing. Given evidence that antitrust enforcement already errs on the side of over-zealous prosecution, however, it does not appear that the public is served well by delegating this responsibility to regulatory authorities.

Appendix AThe Pricing Problem Generalized

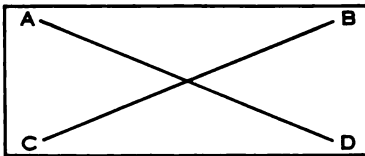
A greatly reduced regulatory role in national telecommunications policy will permit many changes, but the factor of most obvious public concern is the process of setting prices for intercity services. To the casual observer, this may appear to be a simple issue. It may even appear to place the telephone carriers in an adversary position with respect to the public, with the need to balance one's interest in high prices against another's interest in low prices.

In chapters V. and VI., we discuss how prices might be determined in some nontraditional way. To understand what is proposed, and to appreciate how far from the truth is the simplistic appearance of things, it will be helpful to review the basic pricing dilemma presented by a switched network.

Figure 1a depicts four locations, A, B, C and D, representing individuals in a local exchange or cities desiring intercity communications. Each location requires communications services with the remaining three locations.

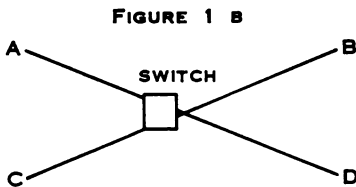
One way in which to provide the desired communications channels would be to construct a unique connection between each and every pair of locations. As illustrated in 1a, such a network would require six communications routes. If each route had an annual cost of \$100, the total annual cost of the system would be \$600.

FIGURE 1 A



TOTAL COST
6 ROUTES @ \$100 = \$600

An alternative communications system would provide only one route from each location. This route would terminate in a switch which could then forward the message, or connect the call, to the desired location. As illustrated in Figure 1b, this network would require 4 routes or circuits and a central switch. If each route again had an annual cost of \$100 and the switch an annual cost of \$100, the total cost of the system would be \$500.



TOTAL COST

4 ROUTES @ \$100, PLUS
SWITCH @ \$100 = \$500

The preceding exposition identifies the economies of the switched telephone network. This result is probably familiar to all who have worked in the telephone industry. The real difficulty begins, however, when we attempt to price the services afforded by the switched network.

Let us assume that each location originated 1,250 minutes of use annually for a network total of 5,000 minutes. One simple and straight forward pricing rule would be to divide cost (revenue requirements) by minutes of use and thereby determine the price to be 10¢ per minute. The derived revenues would just match total cost.

Such a simple approach to pricing is, however, naive, and is likely not to be viable. We must also consider the calling patterns and habits of each individual location. Figure 2 depicts in matrix form a hypothetical calling pattern consistent with the foregoing assumptions.

FIGURE 2
INDIVIDUAL CALLING PATTERNS
(MINUTES)

		TO				
		A	B	C	D	TOTAL
FROM	A	---	1,000	125	125	1,250
	B	1,000	---	125	125	1,250
	C	125	125	---	1,000	1,250
	D	125	125	1,000	---	1,250
	TOTAL	1,250	1,250	1,250	1,250	5,000

Location A originates 1,000 minutes to B, 125 minutes to C, 125 minutes to D, and so forth. Each location originates and terminates 1,250 minutes annually for a network total of 5,000 minutes. Calling habits vary, however, from location to location.

Note, for instance, that there are 1,000 minutes annually from A to B and another 1,000 minutes from B to A -- a total of 2,000 minutes between these two points. At 10¢ per minute, the annual cost would be \$200. A direct connection between these points can be erected for only \$100, however -- a per minute cost of only 5¢. Similarly, there are 2,000 minutes annually between C and D, and similar savings to be afforded by a direct connection.

In this example, a uniform price of 10¢ per minute fails to make viable the efficient network arrangement. Because calls are concentrated along certain routes, there will be economic incentives to construct additional point-to-point connections. These connections increase the network cost to \$700, but afford no added communications capabilities. The connections between A and B, and between C and D, merely siphon 4,000 minutes from the currently existing network. There is excess capacity. In fact, one can observe that the remaining 1,000 minutes which actually use the switched network must now be priced at 50¢ per minute in order to recover total costs.

This over-simplified example ignores important complicating variations, but it illustrates accurately the nature of the problem. Clearly, one does not wish telephone pricing policy to induce excess capacity. What are the alternatives?

1. Prices along heavily utilized routes can be set relatively low in order to discourage point-to-point connections. In the preceding example, a price of 5¢ per minute or lower would eliminate the incentive to build private lines between A and B (and C and D). The remaining routes (A to C, B to D, etc.) must then be charged 30¢ per minute (compared to 50¢ above) for full cost recovery.
2. A surcharge may be placed upon traffic which is diverted from the switched network. In the example, a surcharge of 5¢ per minute on point-to-point traffic would discourage direct connections and excess capacity, while continuing to allow uniform 10¢ per minute rates.
3. Direct reconnections which circumvent the switched network may simply be prohibited by fiat or legislation.

Since the third alternative is inconsistent with national policy, we must confine our solutions to 1. and 2., or combinations of them. Only the first can be done by a private business operating in a free market, as only governments can assess surcharges. Hence the prevalence of bulk rates, volume discounts, and more complex but similar pricing methods in many businesses.

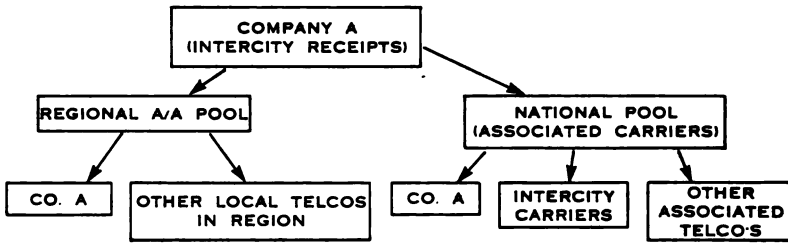
Appendix B

The purpose of this appendix is to illustrate how regionally pooled access and availability charges might be distributed among local telephone operating companies. It may be helpful, however, to begin by reviewing how the revenues from intercity services would flow in the proposed new environment.

Flow of Intercity Revenues

Figure 1 depicts schematically the conceptual flow of intercity revenues. Company A, a local telephone operating company, bills and collects full charges for an intercity traffic which originates in its exchanges. At the end of each period, Company A will determine the total access and availability charges attributable to traffic originating and terminating in its exchanges, and remit or report this amount to a regional pool. The remaining intercity revenues are contributed to a national pool (or pools, if the billing company contracts with competing intercity carriers). The revenues in this national pool will be divided according to formulas privately negotiated by the intercity carrier and its associated local operating companies. Company A will contract to be reimbursed for the costs of billing and collection as well as the costs of any intercity facilities which it owns. The funds in the regional pool will be divided among the local operating companies in that region, subsequent to negotiations among these companies with oversight by the appropriate state commission. Final authority may be left to that level, or taken at the federal level.

FIGURE 1
FLOW OF INTERCITY REVENUES



Distribution of Access and Availability Charges

The objective of this section is to provide a simple illustrative example of how the pooled access and availability charges might be distributed as revenues among local telephone companies within a region. We will assume that the A/A schedules have been determined, the period has ended, and all payments into the pool have been made or reported. Specifically, we assume that the pool consists of \$2.5 million which must be distributed among two local telephone companies, A and B.

Table I contains hypothetical data for these two companies: the total monthly cost of local plant (including return on invested capital), the number of mainstations (m.s.) served, and the monthly cost per mainstation.

Note that Company A is smaller and has higher per-main-station local cost than does Company B.

TABLE I
HYPOTHETICAL OPERATING DATA

<u>COMPANY</u>	<u>TOTAL COST/MO</u>	<u>MAIN STATIONS</u>	<u>COST/M.S./MO</u>
A	\$1,400,000	50,000	\$28.00
B	\$4,200,000	200,000	\$21.00
TOTAL	\$5,600,000	250,000	\$22.40

We discuss below four alternative ways in which this data can be utilized to provide a scheme for distributing the pooled revenues between A and B.

(1) The access and availability charge revenues may be apportioned between A and B according to their respective number of mainstations. As reported in Table II, this would result in a contribution to both companies of \$10/m.s., implying local rates of \$18 and \$11 per month. Note that this method of distributing access charge revenues preserves the absolute differential between the companies' local rates.

TABLE II
APPORTIONMENT BY MAIN STATIONS

<u>COMPANY</u>	<u>% OF M.S.</u>	<u>A/A REVENUES</u>	<u>(A/A)/M.S.</u>	<u>LOCAL RATES</u>
A	20%	\$500,000	\$10	\$18
B	80%	\$2,000,000	\$10	\$11

(2) A/A revenues could be apportioned according to total local costs. In Table III we see that this method of apportionment yields relatively more to the high cost company and consequently diminishes the local rate disparity.

TABLE III
APPORTIONMENT BY TOTAL COST

<u>COMPANY</u>	<u>% OF TOTAL COST</u>	<u>A/A REVENUES</u>	<u>(A/A)/M.S.</u>	<u>LOCAL RATES</u>
A	25%	\$ 625,000	\$12.50	\$15.50
B	75%	\$1,875,000	\$ 9.37	\$11.63

(3) Apportionment of revenues could be based upon a combination of main station and total cost data. A simple method would be to average the percentages calculated in the previous two approaches. This method - the results are tabulated in Table IV - has the advantage of reducing local rate disparity while simultaneously passing on to Company B some of the advantages of its relatively greater efficiency.

TABLE IV
APPORTIONMENT BY M.S. AND TOTAL COST

<u>COMPANY</u>	<u>AVERAGE %</u>	<u>A/A REVENUES</u>	<u>(A/A)/M.S.</u>	<u>LOCAL RATES</u>
A	22.5%	\$562,500	\$11.25	\$16.75
B	77.5%	\$1,937,500	\$ 9.69	\$11.31

(4) A/A revenues could be allocated in order to minimize or even eliminate local rate disparity within the region. In this example, local rates can be equalized if A is granted \$15.60/m.s., with B receiving only \$8.60/m.s. (See Table V). This method of distribution, however, would seriously diminish the incentive of individual companies to pursue cost saving efficiencies.

TABLE V
APPORTIONMENT TO EQUALIZE LOCAL RATES

<u>COMPANY</u>	<u>A/A REVENUES</u>	<u>(A/A)/M.S.</u>	<u>LOCAL RATES</u>
A	780,000	\$15.60	\$12.40
B	1,720,000	\$ 8.60	\$12.40

The menu of alternative distributions can be greatly expanded and embellished. For instance, apportionment might be based upon relative use in addition to or instead of the mainstation or total cost criteria. We believe, however, that relatively simple methods of apportionment can be found which provide support for local (universal) service and which withstand reasonable tests of equity and fairness.

Senator HOLLINGS. Our next panel consists of Mr. Larkin, Mr. Knecht, Mr. Firestone and Mr. Oettinger. We welcome you here. We will start with Mr. Firestone.

STATEMENTS OF EDWARD P. LARKIN, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS; LOUIS B. KNECHT, COMMUNICATIONS WORKERS OF AMERICA; CHARLES FIRESTONE, UCLA; AND ANTHONY OETTINGER, HARVARD UNIVERSITY

Mr. FIRESTONE. Thank you. I am not representing UCLA or any State agency. I do thank you for letting me address the committee on this issue.

I would like at the outset to applaud S. 611 generally as the best of three pending approaches to the area of the communications common carrier amendment to the act. The bill calls for deregulation of terminal and interexchange telecommunications, yet it is flexible in allowing the FCC to regulate rates and services of domestic carriers where essential to protect the public interest.

I think that flexibility is the key. For as we all know, the technological advances are so rapid that the only certainty in this field is that it will change. Congress best role is to establish, or reestablish the goals, the general scheme of regulation, and provide adequate tools for that scheme to be effective.

It does appear that competition and deregulation of carrier interexchange and terminal markets have already spurred innovation, expanded markets and consumer choice, and should continue to do so. Whether the altered scheme of the bills would result in higher or lower local basic telephone rates, is an open question. I do not have access to the information at this time to answer that question, although I suspect that home subscriber rates will increase substantially over a period of time.

In my search I found only two economists in the United States who really understand this question and they disagree.

Senator HOLLINGS. Who are they?

Mr. FIRESTONE. I will supply them later.

My point in testifying here today, however, is not to repeat the economic debate which has characterized these hearings up to now. Rather I would like to address the goals of the law—goals to which competition and deregulation are simply means to achieve—and to suggest additional considerations.

It is in vogue these days to refer to the marketplace. If market forces can be freed to operate, efficiency will result. If market forces cannot operate, such as in natural monopolies, then regulation is warranted. Basically I agree with this. My problem with these bills is that they appear to recognize only the economic marketplace. They are not specifically designed to promote the equally important marketplace of ideas which underlies the first amendment. That is done only incidentally.

In communications we do not move just any cargo along those electronic highways and pipelines. We move information, whether in the form of pictures, words, sounds, bits or electronic pulses. This is information which will eventually enable us as citizens to express ourselves, to search for truth, to vote, to dissent, and otherwise to govern ourselves.

The cargo distinguishes communications from other fields of law. The first amendment sets the outside parameters on Congress power. But it can also provide guidance for affirmative policies.

S. 611, in fact, includes as a new goal of the act, encouraging diversity of ownership and control of telecommunications media. This appears to recognize the first amendment factor, but a more direct approach is preferable. Congress should specifically recognize the marketplace of ideas as a market worth protecting and promoting.

Accordingly, I have four proposals for alterations in S. 611 to implement these concepts, and generally to encourage a greater ability for the public to gain access to diverse information in the technologically uncertain future.

First, encouraging the marketplace of ideas should be stated explicitly in the list of goals in section 101 of the act.

This specificity could take the form of amending the diversity of ownership goal to "diversity of information sources and control of telecommunications." Or, a new goal to "maximize the public's first amendment interest in the marketplace of ideas." Or, simply, "to promote first amendment values."

Second, reserve spectrum space for uses by the nonprofit sector of the economy.

One fear is that in the allocation of the private sector of the spectrum, the corporations designing systems for large corporations will obtain the best frequencies and perhaps all of them. I therefore propose that Congress confer on the FCC the authority and duty to reserve a segment of each spectrum allocation and assignment for noncommercial, nonprofit use. In this way we could continue the practice of reserving educational channels, as in broadcasting, or governmental and educational channels, as in cable. Perhaps in the future we will see new public forum channels—electronic parks—where information is freely transmitted and accessible to anyone.

The purpose here is to serve the first amendment interests by allowing greater public availability or accessibility to diverse information. And it reserves this concept throughout the unforeseen future for new technologies in communications. It would reserve space even where demand is not readily apparent, as we did with noncommercial television and radio.

In the long run, entities should evolve, such as the Telecommunications Cooperative Network, which will serve nonprofit organizations, including even governmental entities. The hope is that new information sources will enter the marketplace and aid us all in arriving at our individual and collective choices. It would apply first amendment theory to the effective media of communications, the electronic media. It would also aid the significant nonprofit sector of our economy in participating in our national communications resources.

This concept might see private corporations utilizing these public frequencies to serve noncommercial nonprofit organizations for a relatively small management fee. We might see futuristic analogies to the Western Union-Corporation for Public Broadcasting arrangement, although I would hope on better terms to the educational or nonprofit institution.

We would reserve public frequencies for direct broadcast satellites, data services, and any other new technological uses devised. In fact, the availability of these frequencies to nonprofits might even spur further innovation.

Third, allow the FCC and States to establish special classifications which favor specified uses of the electronic media.

In section 396 of the present act, Congress authorized the FCC to allow for free or reduced rates for interconnection of public broadcasting stations by communications common carriers. Furthermore, as Judge Malcolm Wilkey of the U.S. Court of Appeals for the District of Columbia Circuit observed with respect to communications common carriers, prices in favor of noncommercial public, educational and governmental users presents no obstacle to the conclusion that a common carrier activity is involved.

Thus I am proposing that governments be given the authority to establish classifications for such preferred pricing.

This could be implemented by a section in the act such as: Nothing in this act is intended to prevent Federal, State or local governments from establishing reasonable classes of noncommercial users or uses for which certain carriers would be obligated to provide services at reduced or no cost.

This could also resolve any legislative problems created by the recent, ill-considered *Midwest Video* decision in the Supreme Court last month.

While this authority need not be utilized by the Commission or the States, as the case may be, it would if used allow for nonprofits' access to certain telecommunications services, or on the local level, for local access channels. This proposal complements the reservation of frequency space suggestion by reaching the same people but with existing, profit maximizing corporations. I would urge that both approaches be adopted.

Fourth: Preference for common carrier usage of the spectrum.

In the House bill, H.R. 3333, Congress would set forth certain priorities in allocating spectrum space. S. 611 establishes a commission to study the uses of the spectrum and to recommend allocation procedures and policies to Congress for the future.

I would suggest, at the least, that a priority or presumption for common carrier—carrier II—usage be a subject of the Spectrum Commission's concern, and at best that an immediate statutory requirement be inserted to that effect. The FCC would then have to reasonably explain why and how the public interest would be served by allocations for noncommon carrier usage.

Another alternative here would be to drastically reduce spectrum usage fees for carrier II usage, since this would encourage greater use of the spectrum by more people, and since such costs are directly passed on to the public anyway. Along these lines, I would allow percentage reductions of spectrum fees for the equivalent percentage of the channel used for common carriage.

For example, if a broadcast allowed 10 percent common carriage on its frequency, the spectrum usage fee might be reduced 10 percent. This gives the broadcaster a financial incentive to provide public access. This is important because under the existing scheme, the Government most severely restricts the public from using broadcasting—the most effective medium of speech—for speech

purposes. Greater public access to those frequencies, along some kind of common carriage concept, is sorely needed in the new law.

Accordingly, I would urge that in defining telecommunications carriers, Congress specify that the exclusion of broadcasters from that category not be intended to defeat governmental regulations which are designed to foster public access over those frequencies at least where such access is not contingent on the content of programming otherwise being broadcast.

In sum, I have tried here to suggest revisions of S. 611 which recognize and apply in the law the concept of fostering a marketplace of ideas as well as an economic marketplace in the communications/information sectors of our economy.

Other general goals which the subcommittee should consider in its overview of a communications law are, first, equality of opportunity for all citizens, and second, protection of personal privacy. While we have other laws, and more are presently under consideration in these areas, I would urge that these basic elements of our legal system be restated or somehow contained in the present legislation.

As I stated earlier, I do not pretend or intend to offer economic testimony. However, my experience in the broadcasting, cable, and common carrier fields does suggest to me a few additional points on some of the major concepts here at issue.

Perhaps the largest consequence of the bills would be in new section 229 which in essence allows the Commission to lift the 1956 A.T. & T. consent order which bars A.T. & T. entry into nonregulated industries. The fear, of course, is that the Bell System would cross-subsidize from its monopoly to its competitive services or products.

The solution in S. 611 is to require separate subsidiaries in virtually every area where cross-subsidization of a nonregulated service might occur. I would support this structural approach as consistent with prior case precedent and as most protective of the public interest short of complete divestiture to noncommon shareholders.

This approach was followed in the first computer inquiry, about which I am sure you have heard from other witnesses. Furthermore, the structural approach has been employed in the broadcast and cable ownership field.

That is, to continue the previous analogy of the marketplace of ideas, where cross-subsidization of ideas was undesirable, the Commission has chosen separate ownership rather than more behavioral type regulation. Thus, the FCC required divestiture of broadcast networks where more than one under common ownership served a given community.

Similarly, one entity cannot own more than one TV, one AM, or one FM station in a given market, even if under separated editorial staffs or accounts.

Finally, in the prospective ban on newspaper broadcast cross-ownerships affirmed last year by the Supreme Court, the FCC bars common ownership rather than assure separate accounting in economic or journalistic terms.

The bases for this approach vary. But one ground particularly applicable to your consideration of the separate subsidiary issue

would be to prevent the potential for abuse. The Government may act without awaiting the feared result.

The potential for abuse, as well as the severity of the consequence if abuse occurs, should be weighed heavily in selecting your remedy. Even with the improved legal machinery provided, the Government will have great difficulty in detecting cross-subsidizations and remedying them in time. Therefore, I support, at the least, the subsidiary concept.

Further, the subcommittee should assure that telecommunications carriers separate mass media programming functions from telecommunications transmission services. In that way, there is no built-in incentive for the carrier to minimize the transmission of others' programming in order to maximize audiences for its own programming for which it would profit in one way or another.

The Cabinet Committee on Cable Communications' Report to the President in 1974 listed this as its top policy recommendation, suggesting that it be implemented by barring any common ownership or control. It is also consistent with the Paramount Pictures case which required divestiture of certain production and exhibition functions in the movie industry. Again, we should not await the feared result. A structural approach now will avoid behavioral problems later.

Mr. Chairman, obviously it is very difficult for representatives of the public to amass the information and to prepare full testimony under the rapid schedule contemplated for these hearings.

Furthermore, deregulation and innovation in telecommunications are proceeding apace without any legislative changes. There is no national emergency; we have the luxury of time to consider these very important issues. With legislation that is so important to us all, I would urge you to consider expanding the hearings to include the views of more public representatives on each of the major provisions.

Further, I hope you will allow me to submit a more detailed analysis of the legislation at a later time.

That concludes my introductory remarks. Again, thank you for inviting me to testify.

Thank you.

[The statement follows:]

STATEMENT OF CHARLES M. FIRESTONE, DIRECTOR, COMMUNICATIONS LAW
PROGRAM, UCLA SCHOOL OF LAW ¹

Mr. Chairman, thank you for giving me this opportunity today to address the very important domestic telecommunications carrier aspects of the pending legislation to revise the Communications Act of 1934. At the outset I would applaud S. 611 generally as the best of the three approaches to the communications common carrier section of the Act. The bill calls for deregulation of terminal and interexchange telecommunications, yet is flexible in allowing the Federal Communications Commission to regulate rates and services of domestic carriers where essential to protect the public interest. (New § 204(c).)

This flexibility is key. For as we all know, the technological advances are so rapid that the only certainty in this field is that it will change. Congress' best role is to establish, or reestablish the goals, the general scheme of regulation, and provide adequate tools for that scheme to be effective.

¹ These views are personal and do not necessarily reflect the views or position of the University of California or any other State agency.

I. GOALS

In Title II you have taken a fair, but somewhat cumbersome law, streamlined the scheme and retained the laudable goals of the Act: "making available, so far as possible, to all the people of the United States, rapid, efficient, nationwide and worldwide telecommunications services with adequate facilities at reasonable charges . . ."

The major legal alterations of Title II of S. 611 are:

- (1) it establishes a new, more rational boundary for federal-state jurisdiction;
- (2) it requires the FCC to refrain from regulation where competition satisfies governmental objectives unless essential to the public interest;
- (3) it lifts the restrictions of the 1956 A.T. & T. consent decree to allow Bell to enter unregulated markets;
- (4) it attempts to prevent cross-subsidizations by requiring separate subsidiaries for non-carrier activities—a subject to which I shall return;
- (5) it strengthens the FCC tools to regulate telecommunications carriers; and
- (6) it allows the State or local governments to regulate local monopoly carriers, including cable television systems.

It does appear that competition and deregulation of carrier interexchange and terminal markets have already spurred innovation, expanded markets and consumer choice, and should continue to do so. Whether the altered scheme of the bills would result in higher or lower local basic telephone rates is an open question. I do not have access to the information at this time to answer that question, although I suspect that home subscriber rates will increase substantially over a period of time.

I would urge, nevertheless, that the Subcommittee include "affordable" as one of its goals for telecommunications services, and amend Sections 101, 201, 204(d) and any other appropriate sections of the new law accordingly. That is, whether or not rates are reasonable, the government should strive, as part of the universal service concept, to make telecommunications services affordable to all. I think the bill intends that, as evidenced by the findings in Section 201(a)(8).

My point in testifying here today, however, is not to repeat the economic debate which has characterized these hearings up to now. Rather I would like to address the goals of the law—goals to which competition and deregulation are simply means to achieve—and to suggest additional considerations. Finally, I intend to address a few other legal points on which I believe I can be of assistance to the Subcommittee.

A. The marketplace of ideas

It is in vogue these days to refer to the marketplace. If market forces can be freed to operate, efficiency will result. If market forces cannot operate, such as in natural monopolies, then regulation is warranted. Basically I agree with this. My problem with these bills is that they appear to recognize only the economic marketplace. They are not specifically designed to promote the equally important marketplace of ideas which underlies the First Amendment. That is done only incidentally.

In communications we do not move just any cargo along those electronic highways and pipelines. We move information, whether in the form of pictures, words, sounds, bits or electronic pulses. This is information which will eventually enable us as citizens to express ourselves, to search for truth, to vote, to dissent, and otherwise to govern ourselves.

The cargo distinguishes communications from other fields of law. The First Amendment sets the outside parameters on Congress' power. But it can also provide guidance for affirmative policies. The FCC, for example, has premised its broadcast ownership restrictions on both antitrust and First Amendment grounds to foster a diversity of information sources.

As a unanimous Supreme Court held ten years ago, the public's right to diverse information is the paramount First Amendment consideration.² As Judge Learned Hand once characterized the marketplace of ideas theory, "To some it is and will always be folly; but upon it we have staked our all."³

S. 611, in fact, includes as a new goal of the Act, "encouraging diversity of ownership and control of telecommunications media." This appears to recognize the First Amendment factor, but a more direct approach is preferable. Congress should specifically recognize the marketplace of ideas as a market worth protecting and promoting.

Accordingly, I have four proposals for alterations in S. 611 to implement these concepts, and generally to encourage a greater ability for the public to gain access to diverse information in the technologically uncertain future.

² *Red Lion Broadcasting Corp. v. FCC*, 395 U.S. 367, 389-90 (1969).

³ *Associated Press v. United States*, 52 F. Supp. 362 (S.D.N.Y. 1943), *aff'd*, 326 U.S. 1 (1945).

(1) Encouraging the marketplace of ideas should be stated explicitly in the list of goals in sec. 101 of the act

This specificity could take the form of amending the diversity of ownership goal to "diversity of information sources and control of telecommunications." Or, a new goal to "maximize the public's First Amendment interest in the marketplace of ideas." Or, simply, "to promote First Amendment values."

(2) Reserve spectrum space for uses by the nonprofit sector of the economy

One fear is that in the allocation of the private sector of the spectrum, corporations designing systems for large corporations will obtain the best frequencies and perhaps all of them. I therefore propose that Congress confer on the FCC the authority and duty to reserve a segment of each spectrum allocation and assignment for noncommercial, nonprofit use. In this way we could continue the practice of reserving educational channels, as in broadcasting, or governmental and educational channels, as in cable. Perhaps in the future we will see new public forum channels—electronic parks—where information is freely transmitted and accessible to anyone.

The purpose here is to serve First Amendment interests by allowing greater public availability or accessibility to diverse information. And it reserves this concept throughout the unforeseen future for new technologies in communications. It would reserve space even where demand is not readily apparent, as we did with noncommercial television and radio.

In the long run entities should evolve, such as the Telecommunications Cooperative Network, which will serve nonprofit organizations, including even governmental entities. The hope is that new information sources will enter the marketplace and aid us all in arriving at our individual and collective choices. It would apply First Amendment theory to the effective media of communications, the electronic media. It would also aid the significant nonprofit sector of our economy in participating in our national communications resources.

This concept might see private corporations utilizing these public frequencies to serve noncommercial nonprofit organizations for a relatively small management fee. We might see futuristic analogies to the Western Union-Corporation for Public Broadcasting arrangement, although I would hope on better terms to the educational or nonprofit institution. We would reserve public frequencies for direct broadcast satellites, data services, and any other new technological uses devised. In fact the availability of these frequencies to nonprofits might even spur further innovation.

(3) Allow the FCC and States to establish special classifications which favor specified uses of the electronic media

In Section 396 of the present Act, Congress authorized the FCC to allow for free or reduced rates for interconnection of public broadcasting stations by communications common carriers. Furthermore, as Judge Malcolm Wilkey of the United States Court of Appeals for the District of Columbia Circuit observed with respect to communications common carriers, prices in favor of noncommercial public, educational and governmental users presents no obstacle to the conclusion that a common carrier activity is involved. Thus I am proposing that governments be given the authority to establish classifications for such preferred pricing.

This could be implemented by a section in the Act such as: Nothing in this Act is intended to prevent Federal, State or local governments from establishing reasonable classes of noncommercial users or uses for which certain carriers would be obligated to provide services at reduced or no cost.

This could also resolve any legislative problems created by the recent, ill-considered *Midwest Video* decision in the Supreme Court last month.⁴

While this authority need not be utilized by the Commission or the States, as the case may be, it would if used allow for nonprofits' access to certain telecommunications services, or on the local level, for local access channels. This proposal complements the reservation of frequency space suggestion by reaching the same people but with existing, profit maximizing corporations. I would urge that both approaches be adopted.

(4) Preference for common carrier usage of the spectrum

In the House bill, HR 3333, Congress would set forth certain priorities in allocating spectrum space. S. 611 establishes a commission to study the uses of the spectrum and to recommend allocation procedures and policies to Congress for the future.

I would suggest, at the least, that a priority or presumption for common carrier (Carrier II) usage be a subject of the Spectrum Commission's concern, and at best

⁴ *United States v. Midwest Video Corp.*, S. Ct. No. 77-1575 (Slip Op. Apr. 2, 1979).

that an immediate statutory requirement be inserted to that effect. The FCC would then have to reasonably explain why and how the public interest would be served by allocations for non common carrier usage.⁵

Another alternative here would be to drastically reduce spectrum usage fees for Carrier II usage, since this would encourage greater use of the spectrum by more people, and since such costs are directly passed on to the public anyway. Along these lines, I would allow percentage reductions of spectrum fees for the equivalent percentage of the channel used for common carriage.

For example, if a broadcaster allowed 10 percent common carriage on its frequency, the spectrum usage fee might be reduced 10 percent. This gives the broadcaster a financial incentive to provide public access. This is important because under the existing scheme, the Government most severely restricts the public from using broadcasting—the most effective medium of speech—for speech purposes. Greater public access to those frequencies, along some kind of common carriage concept, is sorely needed in the new law.

Accordingly, I would urge that in defining telecommunications carriers, Congress specify that the exclusion of broadcasters from that category not be intended to defeat governmental regulations which are designed to foster public access over those frequencies at least where such access is not contingent on the content of programming otherwise being broadcast.

In sum I have tried here to suggest revisions of S. 611 which recognize and apply in the law the concept of fostering a marketplace of ideas as well as an economic marketplace in the communications/information sectors of our economy.

B. Other goals

Other general goals which the Subcommittee should consider in its overview of a communications law are (1) equality of opportunity for all citizens, and (2) protection of personal privacy. While we have other laws, and more are presently under consideration in these areas, I would urge that these basic elements of our legal system be restated or somehow contained in the present legislation.

II. CROSS-SUBSIDIZATION

As I stated earlier, I do not pretend or intend to offer economic testimony. However, my experience in the broadcasting, cable and common carrier fields does suggest to me a few additional points on some of the major concepts here at issue.

Perhaps the largest consequence of the bills would be in new Section 229 which in essence allows the Commission to lift the 1956 A.T. & T. consent order which bars A.T. & T. entry into unregulated industries. The fear, of course, is that the Bell System would cross-subsidize from its monopoly to its competitive services or products.

The solution in S. 611 is to require separate subsidiaries in virtually every area where cross-subsidization of a nonregulated service might occur. I would support this structural approach as consistent with prior case precedent and as most protective of the public interest short of complete divestiture to non-common shareholders.

This approach was followed in the first computer inquiry,⁶ about which I am sure you have heard from other witnesses. Furthermore, the structural approach has been employed in the broadcast and cable ownership field.

That is, to continue the previous analogy of the marketplace of ideas, where cross-subsidization of ideas was undesirable, the Commission has chosen separate ownership rather than more behavioral type regulation. Thus, the FCC required divestiture of broadcast networks where more than one under common ownership served a given community.⁷ Similarly, one entity cannot own more than one TV, one AM or one FM station in a given market, even if under separated editorial staffs or accounts. Finally, in the prospective ban on newspaper broadcast cross-ownerships, affirmed last year by the Supreme Court, the FCC bars common ownership rather than assure separate accounting in economic or journalistic terms.

The bases for this approach vary. But one ground particularly applicable to your consideration of the separate subsidiary issue would be to prevent the potential for abuse. The government may act without awaiting the feared result. The potential for abuse, as well as the severity of the consequence if abuse occurs, should be weighed heavily in selecting your remedy. Even with the improved legal machinery provided, the government will have great difficulty in detecting cross-subsidizations

⁵ Here I would resort to prior definition of common carriage under *NARUC v. FCC*, 533 F. 2d 601, 608-09 (D.C. Cir. 1976).

⁶ *GTE Service Corp. v. FCC*, 474 F. 2d 724, 731-32 (2d Cir. 1973).

⁷ This still exists for television but has been lifted for radio networks.

and remedying them in time. Therefore I support, at the least, the subsidiary concept.

Further, the Subcommittee should assure that telecommunications carriers separate mass media programming functions from telecommunications transmission services. In that way, there is no built-in incentive for the carrier to minimize the transmission of others' programming in order to maximize audiences for its own programming for which it would profit in one way or another.

The Cabinet Committee on Cable Communications' Report to the President in 1974 listed this as its top policy recommendation, suggesting that it be implemented by barring any common ownership or control. It is also consistent with the *Paramount Pictures* case* which required divestiture of certain production and exhibition functions in the movie industry. Again, we should not await the feared result. A structural approach now will avoid behavioral problems later.

Mr. Chairman, obviously it is very difficult for representatives of the public to amass the information and to prepare full testimony under the rapid schedule contemplated for these hearings. Furthermore, deregulation and innovation in telecommunications are proceeding apace without any legislative changes. There is no national emergency; we have the luxury of time to consider these very important issues. With legislation that is so important to us all, I would urge you to consider expanding the hearings to include the views of more public representatives on each of the major provisions. Further, I hope you will allow me to submit a more detailed analysis of the legislation at a later time.

That concludes my introductory remarks. Again, thank you for inviting me to testify.

Senator HOLLINGS. Thank you.

Mr. Larkin.

Mr. LARKIN. Senator Hollings, Senator Goldwater, Senator Cannon, members of the staff, we are delighted to be here to offer our comments to your honorable committee.

I would like to say parenthetically, Senator Goldwater, that we have a large pool of expertise in NARUC that is at your disposal.

We don't find the size of A.T. & T. too overwhelming for us. We have lived with it for many years. Indeed, the rather fine system that exists today exists mostly because we have not been overwhelmed by A.T. & T. regulators have met them at the barriers and met them at the borders. We think that if you have need of assistance, we would be delighted to provide our very large pool of expertise to work with you and for you.

We in NARUC applaud this honorable committee if for no other reason than for the tremendous amount of work it has done to try and embrace an almost-unembraceable subject.

I have been 20 years in regulation and I probably couldn't talk with such authority if I fully understood these bills.

I have found as a regulator when I am absolutely sure of my position, I am probably wrong.

I don't mean that to be humorous because regulation is a very difficult field of endeavor.

I can tell you that I learn something new almost every moment of the day; perish the day I don't. The resolution of this controversy—and that is what it is, because we had a perfectly good system before somebody decided it had to be changed. The changes have been taking place over the past 10 years by accumulation: Somebody wanted a recipe for chop suey and was told there wasn't a recipe.

It accumulated. That is probably what has been happening. The changes have been accumulating and we are delighted that you are addressing the situation. At least now we are able to address our

* *United States v. Paramount Pictures*, 334 U.S. 131 (1948).

concerns to you. And we have real concerns. We have a real concern that the proposed legislation makes major alterations to a fine old building that may only be in need of minor repairs.

We recognize the advent of the computer world. We recognize the need for information transmission. We recognize the existing system doesn't fully address these needs.

Gentlemen, the existing system is capable of addressing those needs. It's a good system. It works very hard, and it has been effective.

I can assure you from my own personal experience—I have traveled over the world at my own expense to visit other systems—what we have here in this country is rather remarkable.

The French people almost called me a liar when I told them of the facility we have for making calls. They said it was incredible. Well, it is incredible. They could not conceive we could make a call from New York to California by way of Dallas, Tex., or by way of a point in Maine or a dozen other ways of making the call.

We have an incredible system, gentlemen. But it's a system. It's not a series of disparate entities that may be considered separately.

It's a system, gentlemen, and any time that you interpose any kind of diversity into an organization or into a system, you are inevitably going to get dislocations and disequilibrium.

The proposed legislation seeks not only to realign the industry structure but to redefine regulatory jurisdictions between the states and the federal authority.

Let me say that we yield to no one in our respect and our belief that it is you who should set national policy. You should make the determinations.

But in carrying out those determinations, we feel that if you define the manner in which those determinations are to be implemented too closely, the implementation will be extremely difficult.

As I said before, and while it may have been humorous, it was serious, too, the system is extremely complicated. Just let me suggest one little complication in one of the bills. If it becomes law, we will have a toll call from one side of the street to the other. This will be hard to explain back home.

This is only one of many, many problems. We have problems with the accounting. We suggest to you that accounting in the regulatory world is almost 90 percent of the action. Unless you have a system of accounts, unless you have a method of accounting, unless you have some way of making determinations, regulation comes to a grinding halt, or at least breaks down in a series of diverse opinions without any consensus with which to formulate a sensible directive.

We have given to this honorable committee a complete analysis of our opinion of the legislation under discussion; I will spare you a recapitulation. Having spent some time sitting in a similar position, I have a great deal of sympathy for you.

Senator HOLLINGS. We will include your entire statement in the record. Thank you.

Mr. LARKIN. Let me just make one point and I will conclude.

NARUC is of the opinion that, although the effort to date by congressional committees to rewrite the Communications Act of

1934 has been heroic, there is an unfulfilled need for greater study of the situation.

We need to be made more fully aware of the effect of what is proposed here, how it will change our present activities, the cost/benefits and who will benefit.

We are not convinced, gentlemen, that we need much of what is proposed nor that existing needs have been adequately addressed.

We realize that we may be presumptuous in the face of all that has gone before in proposing what I am about to propose. However, we feel that the public interest in this legislation is of such importance—I can't overemphasize this—that if any doubt exists as to the efficacy of the proposal, it should be resolved before irreparable damage is done to a very vital sector of the political, social and economic areas of our society.

Accordingly, we propose that a commission—be it Presidential, congressional, or what have you—be appointed, composed of the chairmen of both the Senate and House Communications Subcommittees together with two State and two Federal regulators and someone from the National Telecommunications Information Administration. This commission should conduct hearings and make complete studies in order to devise a feasible way of implementing the will of the Congress, whatever that may be and however it may be expressed.

In our opinion, gentlemen, this would be a salutary step in securing for this country the benefits of what we already have and the changes that may be needed to accommodate a changing technology.

Thank you.

Senator GOLDWATER. I have to go to the floor, Mr. Knecht, but before I go, I want you to know that I have a great interest in putting language in the bill to prevent telephone companies from releasing telephone toll records to law enforcement authorities except under certain circumstances.

I think that is something that concerns you. It's vital we do that.

I would like you to comment on that proposal. I have to go the floor.

Senator HOLLINGS. Thank you, Mr. Larkin.

[The statement follows:]

STATEMENT OF EDWARD P. LARKIN OF THE NATIONAL ASSOCIATION OF REGULATORY
UTILITY COMMISSIONERS

Mr. Chairman and Members of the Subcommittee, my name is Edward P. Larkin, and I am the Second Vice-President of the National Association of Regulatory Utility Commissioners, commonly known as the "NARUC", as well as the Chairman of the Committee on Communications. I am also a Commissioner on the New York Public Service Commission and have served in such office since June 22, 1961. Accompanying me today are Paul Rodgers, NARUC Administrative Director and General Counsel, Margo James, NARUC Director of Congressional Relations and William R. Nusbaum, NARUC Assistant General Counsel.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental agencies of the District of Columbia, Guam, Puerto Rico, and the Virgin Islands, engaged in the regulation of carriers and utilities. The mission of the NARUC is to serve the consumer interest by seeking to improve the quality and effectiveness of public regulation in America.

More specifically, the NARUC contains the State officials charged with the duty of regulating telecommunications common carriers within their respective borders. As such, they have the obligation to assure the establishment of such telecommuni-

cations services and facilities as may be required by the public convenience and necessity, and the furnishing of service at rates that are just and reasonable.

The members of the NARUC appreciate this opportunity to make their views known on S. 611, a bill proposing the "Communications Act Amendments of 1979", and on S. 622, a bill proposing the "Telecommunications Competition and Deregulation Act of 1979".

As you know, last year two members of the House Subcommittee on Communications, Committee on Interstate and Foreign Commerce, introduced the first attempt to "rewrite" the Communications Act of 1934: H.R. 13015, a bill proposing the "Communications Act of 1978". The NARUC testified on H.R. 13015, complaining about the emasculation of State regulatory authority and about the lack of adequate public interest standards.

We are gratified to note that the current efforts, in both Houses of the Congress, to amend the Communications Act of 1934 [47 U.S.C. §§ 151 *et seq.*] are greatly superior to what was introduced in the House in 1978. The NARUC especially applauds the legislative efforts to maintain continuity, in certain areas, between the old and the new. Retention of such social policy goals as universal service and reasonableness of rates indicates at least an awareness by the sponsors of this legislation that such time-proven objectives are in the public interest. However, we believe that this awareness alone is not enough.

The essential thrust of both S. 611 and S. 622 are towards the implementation of competition in the provision of telecommunication services. The NARUC is not opposed to competition. In fact, in certain areas, such as in the provision of terminal equipment, we support the competitive policy. However, we so believe that certain principles, which have been proven to be in the public interest, should not be arbitrarily discarded to obtain changes merely perceived to be improvements.

The Congress must guarantee that the average American, the proverbial "little old lady in tennis shoes", continues to have necessary access to telephone service at reasonable rates. This principal has been the foundation of our current telephone system and I submit, it must remain the foundation. We must not sacrifice on the altar of reform the interests of the "little guy."

The bills seek to provide for the transmission of technological and service information. This is timely and appropriate. However, there has never been any study or regulatory proceeding to determine the needs and desires of the consumers in this market. The Congress has embarked on a program to rebuild a structure that may only be in need of minor repairs.

Nevertheless, we applaud the intervention of the Congress in the telecommunications controversy. The telephone system has been subjected to many changes over the past ten years by regulatory decree and judicial determination. No matter how well intentioned these changes may have been, they did not represent the will of the people, nor were they predicated on adjudicated "public necessity."

If there are unsatisfied consumer needs—and there is evidence to support such a contention—they should be spelled out in proper proceedings before duly authorized and competent tribunals, and the findings of such tribunals enacted into legislative promulgations of policy and intent.

We propose the establishment of a Presidential Commission, appointed by the President, composed of the Chairmen of both the Senate and House Committees, two State and two Federal regulatory Commissioners, together with a member appointed by the National Telecommunications Information Administrator. This Commission could conduct hearings on the need for new services, innovations and changes in the communications structure and could conduct studies and take testimony on the impact of proposed changes and innovations.

We respectfully suggest that the Congress should avail itself of the expertise of NARUC, to help to detail the highly technical changes that would be required in restructuring a telecommunications system that took almost one hundred years to build and cost one hundred billion dollars or more. This system is composed of complexities so myriad and of such magnitude that only the uninitiated would venture to engage them.

The legislation postulates benefits to consumers accruing from the selective deregulation of telephonic services. Nowhere in any public forum or regulatory proceeding of which we are aware have these benefits been spelled out or documented. We do not deny that there may be a need for change, nor would we oppose well-considered alterations of the telephonic system. Our constant concern is with the cost benefit of these changes and the effect on the "public interest."

We applaud the desire expressed in S. 611 to obtain "increased benefits and satisfy future consumer need and to exploit technological opportunities." We respectfully suggest, however, that the existing state of the art of telecommunications has been developed to a degree that permits projection of future consumer needs.

Certainly, proper exploitation of any field of endeavor requires an appropriate plan of action. These elements of consideration are missing from the proposed legislation. Such infirmities would be cured by a Commission such as we propose.

Again, the proposed legislation says, "Basic universal low cost telecommunications services must and can be maintained in an environment of increased competition." However, the bill then proceeds to cast doubt on its own postulate by requiring financial, regulatory and procedural safeguards to protect the system against harms that may be generated by the proposed legislation. The doubts which the bill expresses in its call for safeguards are the same doubts that State regulators experience when they contemplate the effect of the changes proposed in S. 611. The creation of safeguards against self-created dangers to a system that is now working perfectly is a matter of concern and some bewilderment to State Regulators.

The constant concern of NARUC is the maintenance of the low cost message telephone system that we now enjoy. Our efforts in testimony, past and present, have been predicated upon perceived dangers to this fine system.

The bill presumes that, "There are no—economic factors which would preclude—interexchange telecommunications services under conditions of effective competition." This presumption is without factual foundation. However, a fact of economic consideration is that, insofar as message telephone service is concerned, there is demonstrable evidence that competition, as it presently exists and as it is projected by the sponsors of this bill, is not competition at all. Rather, it is a selective allocation of the market which will create diseconomies of scale and result in allocationally inefficient use of our natural resources and national pool of capital.

We are fully aware that the telephone network is presently serving many vital functions other than message transmission. We are also aware of the great and growing need for the transmission of information and data and that such transmissions may, under given circumstances, be accomplished just as cheaply and efficiently by competitive elements as by monopoly entities. However, data and information transmission are peculiar to the commercial and industrial spheres. The users of these services are sophisticated and knowledgeable and are financially equipped to make intelligent choices. However, at this time, average telephone subscribers have none of these attributes and are totally dependent upon this Congress and Federal and State regulators to protect and promote their interests.

NARUC is firmly convinced that the restructuring of the telephone system can best be accomplished if this nation avails itself of the expertise resident in both State and Federal regulatory personnel. Working together, State and Federal regulators could adjust the telephonic system to the needs of the growing data and information transmission market without impairment of the message telephone system. We believe this can be accomplished within the parameters of the enunciated goals and objectives of the Congress.

On the assumption that this will be the NARUC's only chance to testify on the proposed Senate bills, we would like to take this opportunity to make some recommendations as alternatives to the convening of a Presidential Commission proposed above.

The NARUC firmly believes that the public interest is best served when decisions impacting upon the quality of citizens' lives are made by officials who are easily accessible to those citizens. It is these officials, rather than a Federal government located in Washington, who have an intimate knowledge of local situations and who are in a preeminent position to balance any competing interests that may be involved in such decisions.

Given this perspective, we believe that the regulation of all intrastate services and facilities is a subject that is clearly best left to State authorities. We note with appreciation that the bills' sponsors share our belief in the efficacy of local regulation—at least at some level. Thus, the regulation of local exchange service has been left to the State commissions, where it belongs, in both bills under consideration.

The NARUC fully supports the S. 622 concept that the States will determine when competition should be permitted in the provision of local exchange service. The Hollings bill grants this authority to the Federal Communications Commission (FCC). It is our position that to effectively regulate local exchange carriers, and to effectively provide universal exchange service at reasonable rates, the States must be granted the full panoply of regulatory tools, including the authority to decide when competition is feasible. To strip the States of this power, and to grant it to the FCC, makes a mockery of the distinction between State and Federal jurisdiction. Thus, the NARUC recommends that S. 611 be amended so as to provide this necessary regulatory tool for the State commissions.

Another major problem with the Hollings bill relating to State jurisdiction over local exchange service, concerns the authority of the States to define the parameters of the local exchange area. S. 611 allows the States to continue current practices of

determining local exchange areas but limits such authority through the use of Standard Metropolitan Statistical Areas (SMSAs).

As currently drafted, Sec. 226(a) of S. 611 provides that in defining a local exchange area, a State may not extend the boundaries of any such area beyond the boundaries of any SMSA. The NARUC believes that this limitation severely hampers the States in performing their regulatory functions. For example, in New York City, two SMSAs have been created. One, the New York-New Jersey SMSA includes parts of Bronx County, Kings County, New York County, Putnam County, Queens County, Richmond County, Rockland County, and Westchester County as the New York components. This SMSA leaves out Nassau and Suffolk Counties which comprise another SMSA. Under current regulatory practices a call from Manhattan (in SMSA one) to certain parts of Nassau County is an exchange call. A call from Manhattan to farther points in Nassau County or to Suffolk County is also an exchange call, but with added message units to represent increased distance. Under the new scheme, as drafted, the call from Manhattan to any part of Nassau or Suffolk Counties would be a toll call regulated by the FCC. The logic of this distinction is unfathomable. Conceivably you could have a toll call from one side of the street to the other. Thus, if the Congress, in its wisdom, transfers jurisdiction over intrastate toll to the Federal regulators, the NARUC proposes that Sec. 226(a) of S. 611 be amended by providing that a local exchange area may be comprised of contiguous SMSAs. In the New York City example, the New York Public Service Commission would then be able to create one local exchange combining all the major counties of the New York metropolitan area. This amendment would provide the necessary degree of flexibility for effective State regulation and yet allay any fears that a State will attempt to create unreasonably large exchange areas.

To achieve this end, the NARUC proposes the following amendment to the Hollings bill:

Sec. 226. It shall be the responsibility of each State (or any agency or instrumentality thereof) to define the geographic configuration of exchange telecommunications areas within the borders of each such State where any exchange telecommunications area transcends the borders of any State: *Provided*, That the boundaries of any such area shall not extend beyond the boundaries of any contiguous standard metropolitan statistical areas (as defined by the Secretary of Commerce); *And provided further*, That every point within a State shall be included within an exchange telecommunications area.

This amendment adds the "contiguous SMSAs" concept as well as deleting the provisions for Commission oversight. The NARUC believes that if the States are to be permitted to retain their regulatory jurisdiction over local exchange areas then the FCC should not be granted any authority over such areas, including the power to alter exchange boundaries lawfully established by a State commission.

While we have noted with pleasure that the need for State jurisdiction over local exchange service appears to be recognized in these bills, we react with counterbalancing concern to the elimination of State authority over intrastate toll services.

Under the division of regulatory responsibility embodied in the Communications Act of 1934, the FCC regulates approximately 4.8 billion interstate long distance toll calls a year while the State commissions regulate approximately 8 billion intrastate toll calls and 154.3 billion exchange calls a year. In terms of plant investment, the FCC exercises jurisdiction over approximately 30 percent of Bell System plant while the State commissions exercise jurisdiction over the remaining 70 percent and over virtually all of the plant of the independent telephone companies.

It is evident from these figures that the States have had more responsibility in the regulation of telephone common carriers than the Federal government. Furthermore, it can be demonstrated that State regulation has in fact been effective and has fostered the development of a Nationwide telecommunications system beyond compare.

Yet, in spite of consistently successful State efforts at fostering rapid, efficient, universal service at reasonable rates, some believe that State regulation of intrastate toll service should be preempted by the Federal government.

One of the major arguments presented in favor of Federal jurisdiction over all intercity telephone services is based upon a very tenuous position: that it is no longer possible to distinguish between interstate toll and intrastate toll telecommunications on the basis of State boundaries without creating "artificial and irrational barriers" which are allegedly a burden on interstate commerce. However, to combine interstate and intrastate toll under one regulatory realm creates its own "artificial and irrational barriers". It is difficult for the NARUC to accept a scheme which ignores the fundamental nature of our pluralistic constitutional system—local affairs are to be governed by State and local governments. Furthermore, it is

difficult to imagine a Federal bureaucracy located in Washington being able to respond adequately to the diverse needs of the citizens in the various States.

It is well established that the local network is indispensable to obtaining access to the intrastate and interstate toll network. This intimate relationship between the networks is one of the primary benefits of our telecommunications system.

On the State level, regulators have used this relationship to the subscriber's advantage. For example, by allocating an increased share of joint intrastate revenue requirements to optional intrastate long distance calls, the State regulators have, in effect, used the rate disparity that exists between intrastate toll and local exchange service as a tool to keep basic, necessary, local exchange service within the reach of every consumer. This philosophy is endangered by the present proposals.

Furthermore, State institution of rate and cost averaging policies, whereby rates charged for service between any two equidistant points are essentially the same regardless of the specific costs of providing such service, have been instrumental in ensuring that all citizens, urban and rural, have telephone service.

To place intrastate toll service into the hands of Federal regulators would do a disservice to the average subscriber. By depriving the States of their rightful jurisdiction over local prerogatives, and by denying them the use of necessary regulatory tools, while increasing the Federal presence, is certain to result in a more expensive, more inefficient telecommunications system.

Another argument allegedly supporting Federal jurisdiction over intrastate toll services is based upon the fact that a subscriber's rate to call across the country costs less, in many instances, than a toll call within a particular State. Supporters of Federal jurisdiction argue that the FCC would cut rates for the intrastate calls. However, such rate reductions would increase the rate burden imposed on local telephone exchange users.

Over the past 40 years, cost-saving technological improvements in interstate services have been instituted. Such improvements, such as coaxial cable, microwave, and satellite technology, have offset increases to such an extent that interstate rates have declined overall by 25 percent between 1940 and 1974.¹ This cost reduction trend will be greatly strengthened in the future by use of laser beams to transmit long distance calls. However, few, if any, such technological cost-savings can be applied to local operations. Thus, it is clear that cheaper rates in the interstate sector are not due to the efficiency of Federal regulation. Likewise, more expensive rates in the intrastate sector are not due to inefficient State regulation.

In fact, it can be shown that higher rates for intrastate toll services are directly attributable to the failure to reflect the cost of the local network in the rate for interstate calling so that benefits of technological advances could be shared throughout the system.

The NARUC submits that the destruction of State regulatory authority over intrastate toll services in favor of Federal primacy is a policy that will invariably lead to a less effective national communications network. Therefore, we believe that certain amendments should be made to S. 611 and S. 622 to specifically affirm the States' exclusive jurisdiction over *all* intrastate communications, including intrastate private line services, and to protect the States' ratemaking powers.

To accomplish these ends, and, in addition, to implement some of the policies previously discussed in our testimony, we believe that the following amendment should be added to both the Hollings and Goldwater bills:

APPLICATION OF ACT

SEC. ——. The provisions of this Act shall not apply to, and the Federal Communications Commission shall not exercise any authority under this Act with respect to—

- (1) charges, classifications, practices, services, facilities, or regulations for or in connection with—
 - (i) intrastate toll telecommunications service of any carrier; or
 - (ii) local exchange telecommunications service, even though a portion of such service constitutes interexchange or international telecommunications, in any case where such matters are subject to regulation by a State commission; or
- (2) the degree of local exchange telecommunications competition within a State; or

¹ Report of the NARUC Committee on Communications on "An Investigation Into the Economic and Quality of Service Impact on Telephone Service Subscribers Resulting From the Interconnection of Subscriber-Provided Equipment to the Public Switched Telephone Network and From Competition by the Specialized Common Carriers in the Provision of Telecommunications Services," dated May 15, 1974, p. 61.

(3) any carrier engaged in interexchange or international telecommunications solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; or

(4) any carrier engaged in interexchange or international telecommunications solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; or

(5) any carrier to which clause (3) or clause (4) of this subsection is not applicable because such carrier also furnishes interstate mobile radio communications service or radio communication service to mobile stations on land vehicles in Canada or Mexico.

In conjunction with this amendment, it is important that various definitions also be amended so as to exclude the inclusion of intrastate toll service within the ambit of "interexchange telecommunications". Therefore, in furtherance of this goal the NARUC proposes the following amendments:

S. 611

(1) "Sec. 103(16) 'Interexchange telecommunications' means telecommunications between an information source located in one State, Territory, or possession of the United States, or the District of Columbia.

(2) Add a new subsection to "Sec. 103" as follows: "Intrastate toll telecommunications" means telecommunications between an information source located in one exchange telecommunications area within a State, Territory, or possession of the United States, or the District of Columbia, and an information recipient located in a separate exchange telecommunications area or areas with the same State, Territory, or possession of the United States, or the District of Columbia. Interexchange telecommunications retain their intrastate nature when such telecommunications transcend an exchange area beyond State boundaries if such exchange is regulated by a State commission.

S. 622

(1) Amend Sec. 201 (Sec. 225(c)(4) of the Communications Act of 1934) to include, as in S. 611, separate definitions for interexchange telecommunications services) i.e., interstate and international) and intrastate toll telecommunications.

Perhaps one of the most difficult, yet most important, areas for consideration in analyzing and adopting policy on the future of telecommunications relates to the appropriate methodology for ensuring the existence of a viable local exchange network.

The member State commissions of the NARUC have always supported the principle that the public interest is best served when all subscribers have access to reasonably priced telephone services, especially basic telephone service.

Historically, the support for local exchange telephone service has come from the practice of setting toll rates above cost and distributing the excess through the separations and settlements process. The entire procedure has worked admirably well and has resulted in a telecommunications system whereby all facets of the population, rich and poor, urban and rural, high-density and low-density, business and residential, receive excellent service at affordable rates. The key to this system has been, and must continue to be, sufficient financial support by the interstate network for the use of the local exchange network.

It appears from the bills in question that their sponsors support the concept of a financial contribution to the local exchange. Members of the House Commerce Subcommittee on Communications responsible for H.R. 3333, a bill proposing the "Communications Act of 1979", also apparently support this basic premise. However, controversy exists as to the choice of the appropriate methodology to reach the desired result.

All three of these communications bills, S. 611, S. 622, and H.R. 3333, provide for an access charge to be levied against those interstate and intrastate services accessing the local exchange network. However, each bill has a different system to compute the access charge.

At this time, the NARUC is unable to support any of these proposals in the absence of a fuller understanding of their impact, however, the approach found in Sec. 324 of the current version of H.R. 3333 appears preferable, but with amendments. From our perspective, an obvious benefit of the House bill's approach is that it grants to the States the authority to determine both the level of the contribution and the structure of the charges, within the framework of a "transitional contribu-

tion ceiling." This differs from S. 611, which provides for such decisions to be made by a permanent Federal-State Joint Board with apparent FCC oversight, and S. 622, which provides even less authority to the State commissions.

The NARUC also prefers the methodology proposed in H.R. 3333 over the two Senate bills because we are hopeful the formula established in the House version will produce greater revenues to finance local exchange service.

As we have noted, our preference for the House concept is predicated upon certain amendments being made. In our opinion the ten year termination of the "transitional contribution ceiling" is not in the public interest. To provide for a specific level of support which would end abruptly after ten years tends to disadvantage those very individuals for whom a contribution is necessary in the first place. Thus we would move to strike the ten year termination period. If Congress, ten years hence, believes that contribution to support local exchange service is no longer necessary the time to act is then, not now. We would also amend Sec. 324 of H.R. 3333 in order to retain State jurisdiction over both intrastate toll and local exchange service.

As an alternative position, the NARUC would support the establishment and administration of an access charge by a Federal-State Joint Board. This Joint Board would be of a different configuration than presently provided in the Federal-State Joint Board procedure of Sec. 410(c) of the Communications Act of 1934 [47 U.S.C. § 410(c)].

The current Section 410(c) Joint Board is composed of three FCC commissioners and four State commissioners nominated by the NARUC. The Board is required to prepare a recommended decision for review and action by the full Commission. State members of the Joint Board sit with the FCC at any oral argument and participate in all deliberations, but have no voting rights when considering final action.

The access charge Joint Board we propose should also be composed of three members of the FCC and four State commissioners appointed by the NARUC. However, *all* members of the Joint Board would vote, issuing a final decision reviewable *only* by the courts.² Further, *all* aspects of the access charge would fall under the jurisdiction of the Joint Board, thus providing for constant and full participation by both State and Federal regulators.

Therefore, the NARUC recommends, as an alternative to the approach in H.R. 3333, that any access charge provision in legislation amending the Communications Act of 1934 include language similar to the following:

SEC. —. (a) Any person who provides an interexchange or intrastate toll telecommunications service or facility which is physically connected, directly or indirectly, with local exchange switching facilities and plant shall pay an access charge to the Access Charge Fund established under subsection (b).

(b) A Federal-State Joint Board composed of three members of the Commission and four State commissioners chosen by the national organization of the State commissions, as referred to in sections 11506 and 10344 of Title 49, shall establish and administer an Access Charge Fund in order to maintain local exchange telephone service at affordable levels and to ensure the nationwide availability of basic telephone service. All members of the Joint Board shall be permitted to vote on all issues pertaining to the Access Charge Fund. All decisions of the Joint Board shall be final and reviewable only by a court of competent jurisdiction. Joint Board members, and supporting staff members, shall receive such allowances for expenses as the Commission shall provide.

Another major concern of the NARUC relating to S. 611 and S. 622 pertains to the inclusion of a 410(c)-type Joint Board in the legislation. Neither the Hollings nor the Goldwater bills amend Sec. 410(c) of the Communications Act and thus, the Federal-State Joint Board procedures remain intact. The NARUC submits that Sec. 410(c) should be amended to establish an even more meaningful vehicle than currently exists for strengthening FCC-State cooperation in solving regulatory problems of joint concern. Thus, the NARUC recommends that Sec. 410 should be amended as follows:

SEC. 410. (c) The Commission shall refer any proceeding relating to common carrier communications of joint Federal-State concern, when requested in writing by two-thirds of the affected State commissions within forty-five days after the institution of such matter, and may refer any other matter as the Commission deems necessary, to a Federal-State Joint Board. For purposes of acting upon such matter such Joint Board shall have all the jurisdiction and powers conferred upon a hearing examiner provided for in section 3105 of Title 5,

² See Appendix B for legal memorandum on Constitutionality of State Member of Federal-State Joint Board Voting in Final Administrative Decision Making.

designated by the Commission, and shall be subject to the same duties and obligations. The proceedings of the Joint Board shall be conducted in such manner as the Commission shall by regulations prescribe. The Joint Board shall prepare a recommended decision for prompt review and action by the Commission. In addition, the State members of the Joint Board shall sit with the Commission en banc at any oral argument that may be scheduled in the proceeding. The Commission shall also afford the State members of the Joint Board an opportunity to participate in its deliberations, but not vote, when it has under consideration the recommended decision of the Joint Board or any further decisional action that may be required in the proceeding. The Joint Board shall be composed of three Commissioners of the Commission and of four State commissioners nominated by the national organization of the State commissions, as referred to in sections 11506 and 10344 of Title 49, and approved by the Commission. The Chairman of the Commission, or another Commissioner designated by the Commission, shall serve as Chairman of the Joint Board.

(d) The Federal-State Joint Board procedures of subsection (c) are not applicable to the Federal-State Joint Board procedure for establishment and administration of the Access Charge Fund of Sec. —.

(e) The Commission shall, through the use of the Federal-State Joint Board established under subsection (c) of this section:

(1) Include in every proposal, policy statement, report or order, which may have a significant impact on increasing the rates for local exchange telephone service in the future, a detailed statement of such anticipated impact.

Nothing in this subsection shall impair or diminish the powers of any State commission. Joint Board members, and supporting staff members, shall receive such allowances for expenses as the Commission shall provide.

It is important to note that this Federal-State Joint Board procedure does not include jurisdictional separations. The assumption herein in that separations and settlements will be replaced by the access charge. However, if the access charge is deemed insufficient, and the separations and settlements process is retained, then the provisions in the Joint Board procedure pertaining to separations should also be retained.

The Joint Board amendment as proposed combines existing Joint Board procedures and parts of the NARUC's proposed "Home Telephone Act".³ It provides for the mandatory convocation of a Joint Board in all instances concerning common carrier communications of joint Federal-State concern when requested by two-thirds of the affected State commissions. Further, the delineated procedure provides for the voluntary convocation of a Joint Board, at FCC's discretion, on all other matters.

Subsection (d) of our proposed amendment merely states that the Sec. 410(c) type Joint Board is not applicable to the access charge Joint Board procedure.

Subsection (e) of the NARUC's Joint Board plan would require the FCC, through the use of the Joint Board, to examine, and prepare a report on every Commission proposal, policy statement, report or order which may have a significant impact on increasing future local exchange telephone service rates. The Joint Board would also be required to reevaluate existing policy statements, reports and orders whose continuation could also have such an impact.

A final area of significant concern to the NARUC relates to the regulation of cable television (CATV) services. The NARUC believes that CATV, as well as other telecommunications services, has both interstate and intrastate facets. We believe State regulatory authority over all intrastate aspects of CATV and associated broadband services should be retained. Thus, the full gamut of present areas of State control, including the regulation of rates and entry, would be reserved to the States. The States, not the FCC, must be able to determine whether a local telephone company should be allowed to compete in this area.

It is obvious that the changes we have proposed necessitate amending other sections of the bills under review. The NARUC would be most willing to provide the necessary modifying language upon request.

In conclusion, the NARUC would like to strike a final note of caution to this honorable body. With increased emphasis upon the telecommunications of tomorrow and the "age of information", we must all keep in mind the needs of the average

³ The Home Telephone Act was initially drafted by the NARUC in 1974 and subsequently introduced in the 93d Congress by Senator Warren G. Magnuson (on June 4, 1974 as S. 3580) and by the 11 members of the North Carolina delegation (on June 24, 1975 as H.R. 8189). (See *86th NARUC Annual Convention Proceedings*, p. 960 (1974); *87th NARUC Annual Convention Proceedings*, p. 960 (1974); *87th NARUC Annual Convention Proceedings*, p. 845 (1975); and *88th NARUC Annual Convention Proceedings*, p. 947 (1976)).

communications subscriber. Basic necessities such as the capability of promptly summoning medical assistance and fire and police protection must be provided rather than lost in the technological shuffle. The public interest must be protected. Let the goodwill and hardwork that all of us have expended on this legislation be channeled into a force for the good of all the people rather than those with special interests.

Thank you for your attention.

NARUC PROPOSED AMENDMENTS TO S. 611, A BILL PROPOSING THE COMMUNICATIONS ACT AMENDMENTS OF 1979, AND S. 622, A BILL PROPOSING THE TELECOMMUNICATIONS COMPETITION AND DEREGULATION ACT OF 1979

1. Amend S. 611, Sec. 103, by inserting the following after "Application of Act":
 "Sec. 102. The provisions of this Act shall not apply to, and the Federal Communications Commission shall not exercise any authority under this Act with respect to—

"(1) charges, classifications, practices, services, facilities, or regulations for or in connection with—

"(i) intrastate toll telecommunications service of any carrier; or

"(ii) local exchange telecommunications service even though a portion of such service constitutes interexchange or international telecommunications, in any case where such matters are subject to regulation by a State commission; or

"(2) the degree of local exchange telecommunications competition within a State; or

"(3) any carrier engaged in interexchange or international telecommunications solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; or

"(4) any carrier engaged in interexchange or international telecommunications solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier; or

"(5) any carrier to which clause (3) or clause (4) of this subsection is not applicable because such carrier also furnishes interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico."

2. Amend S. 622, Title II, by adding a new section with the same language as in NARUC proposed amendment 1 to S. 611.

3. Amend S. 611, Sec. 104 (Sec. 103 of the Communications Act of 1934), by changing (16), Interexchange Telecommunications, to read as follows:

(16) "Interexchange telecommunications" means telecommunications between an information source located in one State, Territory, or possession of the United States, or the District of Columbia, and an information recipient located in another State, Territory, or possession of the United States, or the District of Columbia.

4. Amend S. 611, Sec. 104, by adding a new subsection to read as follows:

() "Intrastate toll telecommunications" means telecommunications between an information source located in one exchange area within a State, Territory, or possession of the United States, or the District of Columbia, and an information recipient located in a separate exchange telecommunications area or areas within the same State, Territory, or possession of the United States, or the District of Columbia. Interexchange telecommunications retain their intrastate nature when such telecommunications transcend an exchange area beyond State boundaries if such exchange is regulated by a State commission.

5. Amend S. 62, Sec. 201 (Sec. 255(c)(4) of the Communications Act of 1934) to include similar definitions as proposed in NARUC amendments 3 and 4 to S. 611.

6. Amend S. 611, Sec. 223(c), "Basic Exchange Maintenance Program" (Sec. 222 of the Communications Act of 1934) by deleting it in its entirety and inserting Sec. 324, "Interexchange Access Charges", (as amended by the NARUC) from H.R. 3333, a bill proposing the Communications Act of 1979.

Sec. 324 of H.R. 3333 should be amended (1) to reflect the fact that the States retain jurisdiction over intrastate toll as well as local exchange services, and (2) to delete the provision in Sec. 324(c)(2) relating to a ten-year termination point.

7. An alternative amendment to NARUC proposed amendment 6 provides for an access charge Federal-State Joint Board as follows:

SEC. —. (a) Any person who provides an interexchange or intrastate toll telecommunications service or facility which is physically connected, directly or indirectly, with local exchange switching facilities and plant shall pay an access charge to the Access Charge Fund established under subsection (b).

(b) A Federal-State Joint Board composed of three members of the Commission and four State commissioners chosen by the national organization of the State commissions, as referred to in sections 11506 and 10344 of Title 49, shall establish and administer an Access Charge Fund in order to maintain local exchange telephone service at affordable levels and to ensure the nationwide availability of basic telephone service. All members of the Joint Board shall be permitted to vote on all issues pertaining to the Access Charge Fund. All decisions of the Joint Board shall be final and reviewable only by a court of competent jurisdiction. Joint Board members, and supporting staff members, shall receive such allowances for expenses as the Commission shall provide.

8. Amend S. 622, Sec. 225(d)(2)(D) (access charge) so as to reflect the amendments proposed to S. 611 in NARUC proposed amendments 6 and 7.

9. Amend S. 611, Sec. 226, "Definitions of Exchange Area", as follows:

(a) Delete "(a)" on p. 57, line 5;

(b) Delete Subsection (b) in its entirety, p. 57, lines 17-22;

(c) Change line 12, p. 57, to read "the boundaries of any *contiguous* standard metropolitan statistical areas" [amendments underlined]; and

(d) Change lines 13-14, p. 57 by deleting "unless the Commission shall otherwise allow;" and inserting "," immediately after "Commerce)"

10. Amend S. 622, Sec. 201 (Sec. 225(c)(3) of the Communications Act of 1934), by deleting in its entirety and inserting the following:

Sec. —. It shall be the responsibility of each State (or any agency or instrumentality thereof) to define the geographic configuration of exchange telecommunications areas within the borders of each such State, or in conjunction with any State where any exchange telecommunications area transcends the borders of any State: *Provided*, That the boundaries of any such area shall not extend beyond the boundaries of any contiguous standard metropolitan statistical areas (as defined by the Secretary of Commerce): *And provided further*, That every point within a State shall be included within an exchange telecommunications area.

11. Amend Title II of both S. 611 and S. 622 by inserting a new section to read as follows:

Sec. —. Section 410 of the Communications Act of 1934 is amended by deleting subsection (c) and inserting the following:

"Sec. 410. (c) The Commission shall refer any proceeding relating to common carrier communications of joint Federal-State concern, when requested in writing by two-thirds of the affected State commissions within forty-five days after the institution of such matter, and may refer any other matter as the Commission deems necessary, to a Federal-State Joint Board. For purposes of acting upon such matter such Joint Board shall have all the jurisdiction and powers conferred upon a hearing examiner provided for in section 3105 of Title 5, designated by the Commission, and shall be subjected to the same duties and obligations. The proceedings of the Joint Board shall be conducted in such manner as the Commission shall by regulations prescribe. The Joint Board shall prepare a recommended decision for prompt review and action by the Commission. In addition, the State members of the Joint Board shall sit with the Commission en banc at any oral argument that may be scheduled in the proceeding. The Commission shall also afford the State members of the Joint Board an opportunity to participate in its deliberations, but not vote, when it has under consideration the recommended decision of the Joint Board or any further decisional action that may be required in the proceeding. The Joint Board shall be composed of three commissioners of the Commission and of four State commissioners nominated by the national organization of the State commissions, as referred to in sections 11506 and 10344 of Title 49, and approved by the Commission. The Chairman of the Commission, or another Commissioner designated by the Commission, shall serve as Chairman of the Joint Board.

"(d) The Federal-State Joint Board procedure of subsection (c) is not applicable to the Federal-State Joint Board procedure for establishment and administration of the Access Charge Fund of Sec.

"(e) The Commission shall, through the use of the Federal-State Joint Board established under subsection (c) of this section:

"(1) Include in every proposal, policy statement, report or order, which may have a significant impact on increasing the rates for local exchange

telephone service in the future, a detailed statement of such anticipated impact.

"Nothing in this subsection shall impair or diminish the powers of any State commission. Joint Board members, and supporting staff members, shall receive such allowances for expenses as the Commission shall provide."

12. Amend both S. 611 and S. 622 to provide for full State authority over all intrastate aspects of cable television and other broadband services.

APPENDIX B.—CONSTITUTIONALITY OF STATE MEMBER OF FEDERAL-STATE JOINT BOARD VOTING IN FINAL ADMINISTRATIVE DECISIONMAKING

The National Association of Regulatory Utility Commissioners (NARUC) in the above testimony has advocated the establishment of a Federal-State Joint Board whereby all members would be permitted to vote in formulating an administratively final decision, subject only to judicial review. The purpose of this memorandum is to reflect the constitutionality of according the State member the right to vote under such circumstances.¹

ANALYSIS

The principle that the United States Congress can lawfully delegate "Federal" authority to administer and implement its mandates to non-Federal entities has long been established. As early as 1883, in *United States v. Jones*, 109 U.S. 513, 27 L. Ed. 1015, 3 S. Ct. 346 (1883), the Supreme Court, in interpreting an act of Congress transferring to a State board and court authority to ascertain the amount of compensation of United States must pay for the taking of State lands by eminent domain, stated:

"That Government can create all the officers and tribunals required for the execution of its powers. Upon this there can be no question. *Kohl v. U.S.*, 91 U.S. 367 [XXIII., 449]. Yet from the time of its establishment that Government has been in the habit of using, with the consent of the States, their officers, tribunals and institutions as its agents. Their use has not been deemed violative of any principle or as in any manner derogating from the sovereign authority of the Federal Government; but as a matter of convenience and as tending to a great saving of expense." 109 U.S. at 513, 27 L. Ed. at 1015.

The variety of situations wherein the above principle has been affirmed is quite extensive. In fact, the Federal courts have, with an almost tedious repetition, upheld most delegations as being within the lawful power of Congress.² Predominantly, these delegations of authority to implement and administer Federal statutes fall within two major areas: (a) delegations to private entities; and (b) delegations to State officials.

A. Delegation to private entities

As early as 1866 Congress demonstrated its intent that certain statutes were best implemented by private individuals and organizations. In the Mineral Lands Acts, 14 Stat. 251 (1866) and 17 Stat. 92, c. 152, § 5 (R.S. § 2324) (1872), Congress specifically granted to the miners of each mining district on public lands the power to make regulations governing the location, manner of recording, and the amount of work necessary to hold possession of a mining claim. These delegations were consistently upheld by the Supreme Court.³

It was not until 1907, however, that the Supreme Court took the next logical step and affirmed the actual creation of Federal regulations by a private entity. In the landmark case of *St. Louis Iron Mountain & Southern Railway Co. v. Taylor*, 210 U.S. 281, 52 L. Ed. 1061, 28 S. Ct. 616 (1907), the Court held that legislative power was not unconstitutionally delegated to the American Railway Association by Sec-

¹ It would appear that the Joint Board concept itself is beyond controversy considering that the only substantive difference between existing Joint Board procedures [as reflected in 47 U.S.C. § 410(c) and in the Interstate Commerce Act, 49 U.S.C. §§ 10341, 10342, 10343, and 10344] and those proposed, lies in the authority of the Joint Board to issue a final decision voted upon by all members subject only to judicial review.

² Two major striking exceptions are: *A.L.A. Schechter Poultry Corp. v. U.S.*, 295 U.S. 495, 79 L. Ed. 1570, 55 S. Ct. 837 (1935) (constitutionality of the National Recovery Act of 1933) and *Carter v. Carter Coal Co.*, 298 U.S. 238, 80 L. Ed. 1160, 56 S. Ct. 855 (1936) (constitutionality of the Bituminous Coal Conservation Act of 1935). Explanation for these seemingly aberrant decisions lies in the historical period of the Acts themselves as well as in the fact that the delegation issue was not the only basis for the Court's holdings. Since these cases, the Supreme Court has rarely found any kind of delegation unconstitutional.

³ *Jackson v. Roby*, 109 U.S. 440, 27 L. Ed. 990, 3 S. Ct. 301 (1883); *Erhardt v. Boaro*, 113 U.S. 527, 28 L. Ed. 1113, 5 S. Ct. 560 (1885); *Butte City Water Co. v. Baker*, 196 U.S. 119, 49 L. Ed. 409, 25 S. Ct. 211 (1905).

tion 5 of the Safety Appliance Act of 1893, 27 Stat. 531, c.196, which provided that, after a date named, only cars with drawbars of uniform height would be permitted to be used in interstate commerce, and that the standard was to be fixed by the American Railway Association and declared by the Interstate Commerce Commission (ICC). The ICC's power by statute, was limited to "giv[ing] notice of the standard fixed upon to all common carriers, owners, or lessees engaged in interstate commerce in the United States by such means as the Commission may deem proper" (Sec. 5). Thus, the ICC had no power to review the American Railway Association's regulations, but only the authority to implement them—a clear case of delegation to a private entity.

The delegation by Congress, to private groups, of the power to approve regulations prior to their promulgation by a Federal agency has also been repeatedly affirmed by the Supreme Court. In *Currin v. Wallace*, 306 U.S. 1, 83 L. Ed. 411, 59 S. Ct. 379 (1939), the Court upheld a provision of the Tobacco Inspection Act of 1935 (7 U.S.C. §§ 511 *et seq.*) providing for prior approval by two-thirds of the tobacco growers of any orders of the Secretary of Agriculture designating certain markets for inspection before sale.

Similar provisions of the Agricultural Adjustment Act of 1937 [7 U.S.C. § 608 c (a)(B)], providing that orders fixing minimum prices for milk issued by the Secretary of Agriculture were only effective upon approval by two-thirds of interested producers, were found valid in *U.S. v. Rock Royal Co-operative*, 307 U.S. 533, 83 L. Ed. 1446, 59 S. Ct. 993 (1939). There, the Court stated that, "inasmuch as Congress could place the Order in effect without any vote, it is permissible for it to provide for approval or disapproval in such way or manner as it may choose." 307 U.S. at 578, 83 L. Ed. at 1472.⁴

An even more elaborate system of delegated authority was created by Congress in the Soil Conservation and Domestic Allotment Act (16 U.S.C. §§ 590a *et seq.*). Sec. 590h of that Act, and the regulations promulgated thereunder (7 C.F.R., Part 7) provides that local and county committees, comprised of area farmers elected by those with farming interests, shall administer certain sections of the Soil and Conservation and Domestic Allotment Act, as well as certain provisions of other agriculturally related Congressional enactments.⁵

A further example of Congressional delegation to a private entity is found in the Klamath Termination Act of 1954 (25 U.S.C. §§ 564-564x), a statute enacted to terminate Federal supervision over the Klamath Indian Tribe. In *Grain v. First National Bank of Oregon, Portland*, 324 F. 2d 532 (9th Cir. 1963), the Court, in answering a challenge to the constitutionality of the Klamath Termination Act, found that the delegation of authority to the Secretary of Interior to choose a private trustee to manage the property of Indians found unable to handle their own affairs, was valid. Putting the principle quite succinctly, the Court stated, at 537, "While Congress cannot delegate to private corporations or anyone else the power to enact laws, it may employ them in an administrative capacity to carry them into effect."

Quoting from an annotation in 79 L. Ed. 474 entitled "Delegation of Legislative Power", at 485, the Court continued:

"The true distinction is between the delegation of the power to make the law, which necessarily involves a discretion as to what it shall be, and conferring an authority or discretion as to its execution, to be exercised under and in pursuance of the law. The first cannot be done; to the latter no valid objection can be made."

Further illustrations of the validity and use of the delegation principle as to private bodies are too numerous to mention herein. However, one more example perhaps proves the point. In the Railway Labor Act (45 U.S.C. §§ 151 *et seq.*), Congress established a variety of private entities for the purpose of disposing of railway labor disputes. Sec. 153 provides for a National Railroad Adjustment Board consisting of thirty-four members, seventeen selected by the carriers and seventeen selected by labor organizations, such Board to dispose of as many railway labor issues as possible. Furthermore, Sec. 157 establishes an arbitration board for similar purposes. As with most other delegations, the constitutionality has continually been affirmed.⁶

⁴ See also, *H. P. Hood & Sons v. U.S.*, 307 U.S. 588, 83 L. Ed. 1478, 59 S. Ct. 1019 (1939), and 3 ALR2d 188, 196-199.

⁵ For judicial interpretation see *U.S. v. Kopf*, 379 F. 2d 8 (8th Cir. 1967).

⁶ *Brotherhood of Locomotive Firemen and Enginemen v. Chicago, B. & Q. R. Co.*, 225 R. Supp. 11 (D.C.D.C. 1964), affirmed 331 F. 2d 1020 (D.C. Cir.), *cert. denied*, 377 U.S. 918, 12 L. Ed. 2d 187, 84 S. Ct. 1181.

B. Delegation to State officials

The constitutionality of the delegation of authority to State agencies or officials for the administration of Federal statutes finds significant support in the area relating to the use of the State judiciary.⁷ Thus, the delegation by Congress to State courts of the power to enforce the provisions of the Federal bankruptcy statutes⁸ and to naturalize aliens have repeatedly been confirmed.⁹

Furthermore, examples abound of instances wherein Federal and State authorities cooperate, pursuant to Congressional mandates, in the handling of particular matters. This is especially true in the area of criminal law.¹⁰ In addition, there are many instances wherein Congress has ordered the adoption of State laws by Federal officials.¹¹

Underlying almost all delegations to State officials is the implicit, and often explicit, rationale that the matters at issue are predominantly of a local nature, or at the minimum, involve both Federal and State interests. In *Gauley Mountain Coal Co. v. Director of the U.S. Bureau of Mines*, 224 F. 2d 887 (4th Cir. 1955), for example, the Court upheld provisions of the Federal Coal Mine Safety Act of 1952 [30 U.S.C. §§ 478, 479 (b), (d)(9)] which required the State classification of local mines as a condition precedent to Federal regulation. Citing numerous instances wherein similar acts have been affirmed, the Court ruled that, "There is no delegation by Congress of its own power to a state agency, but merely the acceptance by Congress of State action as the condition upon which its exercise of power is to become effective." (*Id.*, at 890).¹²

A primary example of the validity of the delegation principle is also demonstrated by P.L. 89-170, a 1966 amendment to the Interstate Commerce Act. [49 U.S.C. § 11506, formerly 49 U.S.C. § 302(b)(2)]. That amendment authorized the "national organization of the State commissions" [i.e., the National Association of Regulatory Utility Commissioners (NARUC)] to design standards for the registration of ICC certificates of public convenience and necessity by motor carriers.

The language of Sec. 11506 is very specific in providing that the NARUC should design and certify the standards to the ICC which, in turn, shall promulgate the standards "as so certified". Thus, Sec. 11506 is quite similar to Sec. 5 of the Safety Appliance Act of 1893, *supra*, which was found to be constitutional in *St. Louis Iron Mountain & Southern Railway Co. v. Taylor*, 210 U.S. 281, 52 L. Ed. 1061, 28 S. Ct. 616 (1907), *supra*.

Pursuant to the Congressional directive in P.L. 89-170, the NARUC has determined such motor carrier standards, and the ICC has promulgated them into law.¹³ On several occasions, the standards have been amended, again at the NARUC's behest.¹⁴

Further illustrations of the delegation to State officials or agencies of the power to administer and implement Federal acts are highly diverse. Numerous statutes have delegated authority to various State officers to make decisions regarding

⁷ "The instances in which Congress has, through its enactments, made use of the courts of the several states for the effectuation of federal functions are too numerous to need mention." 25th NARUC Annual Convention Proceedings (1913), at 79.

⁸ *Claflin v. Houseman*, 93 U.S. 130, 23 L. Ed. 833 (1876).

⁹ *Levin v. U.S.*, 128 Fed. Rep. 826 (8th Cir. 1904); see also, *State of Indiana v. Killigrew*, 117 F. 2d 863 (7th Cir. 1941) where the Court affirmed the power of Congress to impose a duty upon the clerk of a State court exercising jurisdiction to naturalize aliens to collect and account for naturalization fees.

¹⁰ *Duncan v. Madigan*, 278 F. 2d 695 (9th Cir. 1960); *Gereau v. Henderson*, 526 F. 2d 889 (5th Cir. 1976).

¹¹ *U.S. v. Gerlach Live Stock Co.*, 339 U.S. 725, 94 L. Ed. 1231, 70 S. Ct. 955 (1949); *U.S. v. Sharpnack*, 355 U.S. 286, 2 L. Ed. 282, 78 S. Ct. 291 (1958); *Wallach v. Lieberman*, 366 F. 2d 254 (2nd Cir. 1966).

¹² In accord: *U.S. v. Matherson*, 367 F. Supp. 779 (D.C.S.D.N.Y. 1973); *Clark Distilling Co. v. Western Maryland R. Co.*, 242 U.S. 311, 61 L. Ed. 326, 37 S. Ct. 180 (1917).

¹³ The NARUC first determined motor carrier standards at the 78th Annual Convention in 1966 (Convention Proceedings, at 371). The ICC promulgation appeared in 31 Fed. Reg. 16567-16575 (Dec. 28, 1966); 49 CFR, Part 1023.

¹⁴ 80th NARUC Annual Convention Proceedings, at 263 (1968) [33 Fed. Reg. 19250 (Dec. 25, 1968)]; 81st NARUC Annual Convention Proceedings, at 375 (1969) [35 Fed. Reg. 2524 (Feb. 4, 1970)]; 82nd NARUC Annual Convention Proceedings, at 396 (1970) [36 Fed. Reg. 3417 (Feb. 24, 1971)]; 85th NARUC Annual Convention Proceedings, at 197 (1973) [38 Fed. Reg. 32580 (Nov. 27, 1973)]; 88 Fed. Reg. 33772 (Dec. 7, 1973)]; 87th NARUC Annual Convention Proceedings, at 243 [41 Fed. Reg. 5395 (Feb. 6, 1976)]; 88th NARUC Annual Convention Proceedings, at 274 (1976) [42 Fed. Reg. 6370 (Feb. 2, 1977)].

Federal funding¹⁵, and many other statutes have authorized the Federal adoption of State standards relating to safety and environmental quality.¹⁶

More recent examples of the delegation principle have occurred with the enactment of the National Energy Conservation Act, P.L. 95-619, 92 Stat. 3206 (Nov. 1978), and the Powerplant and Industrial Fuel Use Act, P.L. 95-620, 92 Stat. 3289 (Nov. 1978). Under the Conservation Act, the governors of the various States are given authority to formulate and implement energy plans as well as the authority to waive suppliers from certain requirements.

The Powerplant and Industrial Fuel Use Act grants even more authority to the States. Under the Act, the Economic Regulatory Administration (ERA) has the prerogative of fully delegating responsibility and authority for implementation of Sec. 402, pertaining to the prohibition on the use of natural gas for decorative outdoor lighting, to the State regulatory commissions. In fact, rules have been proposed by ERA delegating full authority to the States including the power to make all rules and regulations necessary to enforce the Congressional prohibition in Sec. 402.¹⁷

III. CONCLUSION

It is clear from the vast number of precedents cited above, that Congress has the power to validly delegate to non-Federal entities the authority to administer and implement Federal statutes. With the exception of the *Schechter Poultry* and *Carter Coal* cases, *supra*, such delegations have invariably been affirmed by the courts. Thus, it would appear that any constitutional challenge to an access charge Joint Board as envisioned herein would be a futile gesture.

PAUL RODGERS,
General Counsel.

WILLIAM R. NUSBAUM,
Assistant General Counsel.

May 3, 1979.

Senator HOLLINGS. Mr. Oettinger.

Mr. OETTINGER. Thank you, Mr. Chairman.

My name is Anthony G. Oettinger. I am a professor at Harvard University, where I chair the program on information resources policy. I am also the holdover chairman of the Massachusetts Cable Television Commission, a body I've served on since 1972. I speak here only for myself, not for any institution with which I am affiliated, nor for any of the 70 or so diverse public or private organizations that support the Harvard program's work. [List attached.]

It is a pleasure to testify before you once again. Now that you've jumped in to drain the swamp, I want to point out a few alligators.

We have been busy analyzing a lot of the data folks here have alluded to. There is too much to present here, but we tried to make explicit and intelligible something of the mind-boggling complexity that folks have alluded to. We had some success in quantifying

¹⁵ The Hill-Burton Act, 42 U.S.C. §§ 291a *et seq.*, provides for Federal funding of State hospitals with the State determining which individual projects to receive financial assistance. [See *Euresti v. Stenner*, 327 F. Supp. 111 (D.C. Colo. 1971)] reversed and remanded on appeal but not as to delegation issue, 458 F. 2d 1115 (1972); the Social Security Act, 42 U.S.C. §§ 603, 607, conditions the release of AFDC—UP assistance funds upon the submission of a State plan and permits the States to determine who shall receive such funds [See *Carroll v. Finch*, 326 F. Supp. 891 (D.C. Alaska 1971)]; the *Public Works and Economic Development Act Amendments of 1976*, 42 U.S.C. sec. 3121 *et seq.*, provides for Federal disaster assistance upon determination of need by the governor of any State; the Public Utility Regulatory Policies Act of 1978, P.L. 95-617, 92 Stat. 3117, provides, in Sec. 603, for the payment of Federal grants to an institute "established by the NARUC".

¹⁶ See the Natural Gas Pipeline Safety Act of 1968, 49 U.S.C. §§ 1671 *et seq.*, esp. §§ 1672, 1673; and the Environmental Quality Improvement Act of 1970, 42 U.S.C. §§ 4371 *et seq.*, which specifically states that the "primary responsibility for implementing this policy rests with State and local governments", 42 U.S.C. § 4371(b)(2). See also *U.S. v. Cincinnati Transit, Inc.*, 337 R. Supp. 1068 (D.C.S.D. Ohio 1972) discussing provisions of the Economic Stabilization Act of 1970, and amendments thereto, 84 Stat. 799, providing for local regulatory agency review and certification of all public utility rate increases.

¹⁷ See 44 Fed. Reg. 9570 (Feb. 13, 1979).

what Paul Henson described in the preceding panel as the unquantifiable.

It's too much to present orally. My full testimony, with your permission, I would like to enter in the record along with additional comments by my colleagues, Kurt Borchardt and John LeGates. Mr. Borchardt's remarks are addressed to the matters of network management and system control in the absence of the old ways. Mr. LeGates' remarks address themselves primarily to some of the questions of divestiture and their consequences.

With your permission, I would like also included in the record—by reference—some of our testimony yesterday before the House where we touched on still other matters. We would be delighted to integrate some of these things for you and the staff and present them as a coherent picture, but my comments today focus on how telecommunication costs and benefits are to be apportioned between consumers of local exchange telecommunications services and consumers of interexchange—toll—services. I believe that continuing controversies on this score are unavoidable. The issue is how best to channel them. The cost picture is where all the action is and continuing controversies on this score are unavoidable. The issue is how best to channel them. They will not disappear. They can't be legislated away.

The Hollings and Goldwater bills put the presently federally regulated interstate toll services and the presently State-regulated State toll services under federally supervised interexchange services. Local exchange matters are left to the States, except for cost allocations, where a Federal presence is mandated.

By displacing a buffering role hitherto played by the State governments, this may lead to unmanageable confrontations between the Federal Government and local political powers. At the same time, the set of players is getting larger, less clubby, more visible, more contentious.

I shall only sketch my argument orally, trusting I have your permission, Mr. Chairman, to enter the supporting written details into the record.

Right now, cost allocations are mediated principally by the so-called jurisdictional cost separations process and the related revenue settlements process. As I see them, the principal functions of these present processes are as follows:

One, to allocate economic costs between the Federal and State jurisdictions, hence to define the total revenues permitted to be drawn from consumers in each jurisdiction.

Two, to modulate economic cost allocation with equity considerations while staying within the bounds of applicable legislative and judicial mandates. That means sloshing costs and revenues one way or another in a matter detailed with numbers and estimates in the exhibits that support my full testimony.

Three, to mediate idiosyncratic political balances between toll and exchange prices in each of the States.

Four, to keep relative peace in dividing revenues among the 1,500 or so current suppliers of traditional telecommunications services.

Five, to lend economic clout to the essential process of keeping the multiple suppliers of traditional telecommunications services in technical and operational harmony.

A continuing need for such administrative functions is recognized by various provisions of S. 611 and S. 622. If anything, the burdens of carrying them out will grow heavier as the number and variety of competing suppliers and anxious consumers grows and if the proposed exchange/interexchange boundary replaces the State/interstate border. That is my first major point. In light of the findings of the bills before us, it needs no elaboration. At issue is who shall bear these burdens, how effectively, and with what kind of policing.

The fact that A.T. & T. alleged in the past that they were the only ones competent to carry out these functions and that there is a tendency among some of the A.T. & T. competitors to reject that allegation should not blind us to the notion that the functions may well be essential and need to be carried out somehow. I think it's important to make that distinction so we don't throw out—I won't say the baby—the gorilla with the bath water.

I shall limit my comments here to the third of the functions I have mentioned; namely, that of balancing toll and exchange prices in each of the states. The balance now struck differs from State to State.

We can see something of what this balancing entails by looking at how widely both toll and exchange rates vary State by State.

This is 1976 data. The first exhibit—exhibit 23 of my written testimony for the record—shows that in Montana you pay a 30-cent toll to talk for 3 minutes during the day to someone 25 miles away. In Mississippi you pay 92 cents. The second exhibit—exhibit 24—shows that in the evening Ohio is now on top with 62 cents and Michigan at the bottom with 25 cents. At night, the third exhibit—exhibit 25—shows that Ohio still has the most expensive call at 59 cents, but Kansas now has the cheapest, at 16 cents. I should add that there is equally pronounced State-by-State variability in the book costs of interexchange plant. Hence State-by-State variability would occur under competitive true cost-based pricing, though not at all necessarily with the same pattern.

The fourth exhibit—exhibit 26—shows how basic rock bottom exchange rates vary around some major patterns. On top, with crosses, are basic business rates. On the bottom, with dots, are basic residential rates. By decades-old custom, basic business rates are roughly twice the basic residential rates. Both types of basic rates generally go up according to the number of other telephones that may be reached within a local calling area. But, around these broad trends, there is again pronounced variability.

I want to call your attention to that variability State by State.

My second major point, Mr. Chairman, is that each of the States, to make up its State cost pool, as now defined by jurisdictional separations, now adjusts relative State toll and local exchange prices by its own lights, reflecting its own economic and demographic patterns of both household and business consumers, its own urban/rural balances, and its own regard or disregard of the merits or demerits, powers or weaknesses of the communications suppliers within its borders.

Hence it will not be an easy administrative task either to harmonize or to dissociate State toll and interstate toll rates under the new common interexchange—Federal—umbrella envisaged by S. 611 and S. 622. Nor can this task be guaranteed to be devoid of political consequences, since making any change in State toll prices, up or down, will gore someone's ox or at least prick the skin of someone's calf.

Failure to change also implies certain risks. Wide variability in State toll prices may have remained unnoticed by many, or at least accepted by those doing business within many States as one of these peculiar consequences of State sovereignty within our federation. Such variability may be harder for Federal authorities to explain and sustain if what are now State toll prices fall under Federal interexchange authority. And it may be hard to do away with the variability without a myriad of Federal/local fights. Such fights are bound to arise over what proportions of exchange costs are to be reflected in local service prices and what proportions are to be charged to interexchange services, hence reflected in interexchange prices. The terms actual cost and relative use in S. 611 have a deceptive clarity. They hide the problem or, at best, they pose it. They surely do not solve it. They have, in fact, been the very battlefield of the last 30 years' war.

Let me summarize my two major points, Mr. Chairman, and make their import explicit. First, I have pointed out that present and prospective competition increases the number of interested parties within the telecommunications, data processing and other supplier industries; notably the U.S. Postal Service. It has already increased and promises to continue to increase the awareness and participation of consumers, both household and business; in short, what was a relatively small private club is going public in a big way. Second, shifting jurisdictional boundaries as envisaged by S. 611 and S. 622 will, I think, eliminate much of the buffering that joint boards and State responsibility for State toll provided in insulating Federal authorities from State-by-State, locality-by-locality accommodations between toll and exchange prices.

The effect is to set up potentially unmanageable Federal/local confrontations.

The House bill leaves a buffering role to the States. That may be an important point requiring accommodation between the two Chambers, after considering the relative impact on the administrability of the legislation as between these two approaches.

I also urge you to consider leaving greater administrative discretion to the FCC. Give them better guidelines, but I think if you inject the Congress into setting up and administering the detailed apparatus for your "giant handicapping" scheme you will end up grooming the horses, taking the bets, paying off every winner, soothing every loser, and shoveling away all the manure. That's what administrative agencies were created for in the first place.

I thank you for your attention.

[The statement and attachments follow:]

STATEMENT OF ANTHONY G. OETTINGER, CHAIRMAN, PROGRAM ON INFORMATION
RESOURCES POLICY, HARVARD UNIVERSITY

Mr. Chairman, my name is Anthony G. Oettinger. I am a professor at Harvard University, where I chair the Program on Information Resources Policy. I am also

the holdover chairman of the Massachusetts Cable Television Commission, a body I've served on since 1972. I speak here only for myself, not for any institution with which I am affiliated, nor for any of the 70 or so diverse public or private organizations that support the Harvard Program's work (list attached).

It is a pleasure to testify before you once again. Now that you've jumped in to drain the swamp, I want to point out a few alligators.

Mr. Chairman, what is an economically efficient and also an equitable allocation of costs is the question most fought over throughout the history of telecommunications. It is, I think, the question underlying all the other questions about the bills before us. Everyone's stakes depend on the answers. For household and business consumers, the answers influence who pays how much for what. The answers influence the ability of competing suppliers to recover costs, including return on investment, without either predatory pricing or unfair burdens. They determine the political, economic and technological viability of this "giant handicapping scheme", if I may, Mr. Chairman, borrow your description of S. 611.

My comments focus on how telecommunications costs and benefits are to be appropriated between consumers of local exchange telecommunications services and consumers of interexchange (toll) services. I believe that continuing controversies on this score are unavoidable. The issue is how best to channel them.

The Hollings and Goldwater bills put the presently federally regulated interstate toll services and the presently state regulated state toll services both under federally supervised interexchange services. Local exchange matters are left to the states, except for cost allocations, where a federal presence is recognized.

By displacing a buffering role hitherto played by the state governments, this may lead to unmanageable confrontations between the federal government and local political powers. At the same time, the set of players is getting larger, less clubby, more visible, more contentious.

Right now, cost allocations are mediated principally by the so-called jurisdictional cost separations process and the related revenue settlements process. Mention of these current processes widely draws snickers or dirty laughs. On their face, these processes do place among the more bizarre and occult forms of gerrymandering ever devised. However, without passing on the merits of the outcomes of these processes themselves, as polished jewels of effective administrative practice. As I see them, the functions of these present processes are as follows:

1. To allocate economic costs between the federal and state jurisdictions, hence to define the total revenues permitted to be drawn from consumers in each jurisdiction.
2. To modulate economic cost allocation with equity considerations while staying within the bounds of applicable legislative and judicial mandates.
3. To mediate idiosyncratic political balances between toll and exchange prices in each of the states.
4. To keep relative peace in dividing revenues among the 1500 or so current suppliers of traditional telecommunications services.
5. To lend economic clout to the essential process of keeping the multiple suppliers of traditional telecommunications services in technical and operational harmony.

A continuing need for such administrative functions is recognized by various provisions of S. 611 and S. 622. If anything, the burdens of carrying them out will grow heavier as the number and variety of competing suppliers and anxious consumers grows and if the proposed exchange/interexchange boundary replaces the state/interstate border. That is my first major point. In light of the findings in the bills before us, it needs no elaboration. At issue is who shall bear these burdens, how effectively and with what kind of policing.

I shall limit my comments here to the third of the functions I have mentioned, namely that of balancing toll and exchange prices in each of the states. The balance now struck differs from state to state.

The cost allocation question has persisted. I believe it cannot be legislated away. Why? Because I believe that what economists call "economies of scope" are inherent in past, present and foreseeable communications technologies, even though their extent in particular cases and at particular times are debatable and will forever be debated. There are economies of scope if a bundle of goods costs less to produce when capital and labor are shared in producing them rather than devoted by one or many suppliers to producing each in isolation from the others. Many of the controversies of the last decade would have gone away without legislation if this were not so for much of the communications technologies.

Please note that economies of scope are distinct from economies of scale, which refer to lower costs per unit of production as the scale of production grows. The concepts are not unrelated, however. Conceivably, if each good in a bundle could be

produced independently of the others with significant economies of scale, these could outweigh the economies of scope realized from producing them together. In that case, we could be economically efficient without being caught in the thicket of joint and common costs wrestling with the thorny problem of cost allocation. But we are deep in that thicket now. I see no real prospect of leaving it, however many of its thorn bushes we might hack away, or however many satellite orbits we might leap into so as to bypass parts of it.

I therefore focus my comments on S. 611 and S. 622 on how they put the question of cost allocation as distinct from how that question has been put in the past. This leads into examining the processes proposed in S. 611 and S. 622 for addressing the cost allocation and consequent questions.

The issue is joined in S. 611's proposed finding that "basic, universal, low-cost public telecommunications services must and can be maintained in an environment of increased competition, through appropriate financial, regulatory and procedural safeguards incorporated in both statutory policies and industry relationships" (Sec. 201(a)(8), p. 19), and in the statement that it "be the policy of the United States that such services and equipment be provided under conditions of full and fair competition, to the maximum extent feasible and consistent with the purposes of this Act" (Sec. 203, p. 20). Similar objectives are explicit in Section 201 of S. 622 (p. 4).

S. 611 and S. 622 thus do not and, I believe, cannot eliminate the long-standing tension between, on the one hand, the traditional cost-averaging practices evolved by the telecommunications industry and its regulators at all levels of government and, on the other hand, the pressures toward cost-related pricing induced by competition. How these tensions are to be handled therefore remains of central importance.

In this context, the bills propose replacing the interstate/state jurisdictional boundary with a boundary between federally regulated interexchange (toll) services and state regulated exchange (local) services (S. 611, Section 223(c), p. 53; S. 622, Section 201, p. 5). S. 611 requires interexchange carriers "to reimburse local exchange carriers directly for the *actual costs* [emphasis added] of originating, terminating, or transferring interexchange telecommunications services" (p. 53, lines 12-14). It recognizes the unavoidable commingling of jurisdictional interests by giving the F.C.C. "authority to review, in the aggregate, exchange costs and revenues to ensure that there is no unlawful discrimination in the use and pricing of exchange facilities as between exchange and interexchange services" (p. 54, lines 4-8). It would then further authorize the collection of certain fees from all interexchange carriers. These fees would be disbursed under supervision of a federal/state joint board to local exchange operators in a way defined "solely on the basis of *relative use* [emphasis added] of exchange facilities by exchange and interexchange services" (p. 55, lines 8-10). All this is meant to replace the processes hitherto "commonly referred to as jurisdictional separations" (p. 53, lines 8-9). Similar mechanisms for cost allocation are envisaged by S. 622, which also distinguishes voice grade from other services (p. 5), thereby further complicating the question of what costs how much.

The principal purpose of my testimony, Mr. Chairman, is to alert you to likely consequences of the proposed Section 223(c), for all affected constituencies and for the effective administration of the law. My colleagues Kurt Borchardt and John C. LeGates focus their testimonies on specific implications for the processes envisaged by other sections of the bill. Toward these ends, I wish to note for the record a working paper, "National Stakes in the Communications Revolution: Jurisdictional Cost Separations," recently issued for comment by the Harvard Program on Information Resources Policy. That paper contains much of the data and analysis that support our further testimony. It is not yet a finished product, but has already undergone enough of our Program's external reviewing process to assure me that it is correct in the main, although incomplete and not necessarily correct in certain details that could be important in an adjudicatory context, but are too fine grained to matter in a broadly brushed picture.

With exceptions I will note as they arise, all data I will present to you are for the year 1976. This is the most recent year for which I found it possible to map the comprehensive yet detailed national picture I believe you require for national legislative purposes.

Exhibit 1 shows, by jurisdiction, the dollar stakes of the traditional telecommunications industry (Bell System and Independents) and their consumers. It also shows the shares of state revenues derived from state toll and local exchange services. It seems safe to assert that aggregate stakes of competitors and their customers are of comparable magnitude, although we have not yet had the time or resources to make a more precise determination. The proportions of jurisdictional cost in Exhibit 1 (and therefore the proportions of the revenues from consumers in these jurisdic-

tions) are far from God-given, technologically immutable, economically determinate, timeless truths. They stem from cost allocations and related arrangements determined by the minds and pens of your predecessors in the Congress, as interpreted by generations of industry managers and of federal and state regulators. They are political allocations at the federal, state and local levels.

Over the years, the relative proportions of joint and common costs recovered from interstate toll, state toll and local exchange charges have changed in response to changes in technology, markets, judicial decisions and political balances.¹ Terms such as actual cost and relative use are putty, not bedrock. Historically, the remarkably and ingeniously malleable interpretations of the terms actual cost and relative use that appear in Section 223(c) of S. 611 have provided the means for accommodating to these vast changes. That is partly why the jurisdictional separation process has been significant. That is why the determination of actual cost will remain significant under any legislative mandate. The malleability of actual cost leaves plenty of room for the inevitable future arguments over the fairness of burdens allocated to the proposed interexchange (federal) and exchange (state) jurisdictions.

Neither is relative use a sole or sacred cost criterion. Without stretching any of the arguments that regulators and judges have accepted in the past from those who argued there was too much or too little loading on this or that to support claims of predatory pricing, undue burdens or other inequities or inefficiencies, I suggest (in Exhibit 2) that a widespread of changes in cost allocations might be supported, in either direction, by such arguments. Note that a dollar cost allocation change is more highly leveraged in the interstate realm than in the state realm, given the 30:70 ratio of interstate to state cost allocations that obtained in 1976. Present law leaves to state regulators the task of wrestling over how much of a cost change between a 21 percent increase and an 11 percent decrease (Exhibit 2) might devolve on state toll consumers and how much on local exchange consumers.

Hence, Mr. Chairman, the terms actual cost and relative use in S. 611 have a deceptive clarity. They hide a problem or, at best, they pose it. They surely do not solve it. They have, in fact, been the very battlefield of the last 30 years' war. Consider, in that light, the aggregate consequences of shifting the jurisdictional boundaries as envisaged in Section 223(c) and reflected in Exhibit 2a. Exhibit 3 shows how 1976 costs would be allocated to the proposed interexchange (federal) and exchange (state) "jurisdictions" under current ground rules. The posts are of nearly equal size.

Exhibit 4 shows how much variation between interexchange and exchange costs I think can be rationalized for the courts and the public with arguments no more bizarre than any used to date. Under the Act of 1934, however, the problem of balance between state toll and exchange revenues is for each state to wrestle with as it sees fit. Under S. 611, state toll would come under the interexchange (federal) rubric. However, by giving the F.C.C. explicit authority to review the aggregate balance of interexchange with exchange costs and revenues, Sec. 223(c) (p. 54, lines 4-8) would appear also to inject a federal presence at the borders of local political powers who hitherto dealt only with their State House and their phone companies.

In preparing Exhibit 4 I have therefore explicitly allowed for variation in the state toll/local exchange proportions. Given the 50:50 interexchange/exchange cost ratio as of 1976, a dollar can be sloshed one way or the other with equal leverage. However, the size of the exchange pot could be made to vary between a 41 percent increase and a 26 percent decrease under explicit federal scrutiny. Before, each state had the option of loading an average 21% increase in state allocation entirely into a 30% increase in local costs or entirely into a 70% increase in state toll costs, or somewhere in between. Likewise for an average 11% decrease.

For better or worse, passage of S. 611 or S. 622 therefore would raise to the federal level unavoidable local arguments hitherto spread around all the states and handled within the framework of state politics. Some additional data will give you further insight into the stakes in these arguments, and into the administrative and political consequences of raising these arguments to the federal level.

The perceptions of parties to these arguments can vary widely. The data in Exhibits 1-4, and the jurisdictional separations practices underlying them (described in detail in my previously cited "National Stakes in the Communications Revolution: Jurisdictional Cost Separations") can be viewed as evidence for a present overloading of costs onto the consumers of federally regulated interstate toll services. On the other hand, the data I am about to exhibit can be viewed as evidence for overloading of costs onto the consumers of state regulated state toll services. To reconcile

¹ A historical account is given in James W. Sichter, "Separations Procedures in the Telephone Industry: The Historical Origins of a Public Policy," Harvard Program on Information Resources Policy, Publication P-77-2, 1977.

these perceptions, it is necessary to draw on details of consumer demand for various services which my colleague John McLaughlin is beginning to develop in connection with his studies of tradeoffs between postal and telecommunications services, but which are not yet in hand.

Exhibit 5 is a map of the United States, with distances from Jefferson City, a place about at the center of Missouri. It's a familiar picture, which I'll call the geographic map of the United States. I call the four other exhibits I'm about to show you telephonic maps. Whereas the geographic map shows actual shapes with the circles showing miles, the telephonic maps will show costs, not distances, from Jefferson City.

Exhibit 6 is the first telephonic map. The map shows how much it costs to call from Jefferson City, Missouri, to any place in the United States beyond the Missouri border during the day and talk for 3 minutes. This means that all places that cost the same to call from Jefferson City lie on a circle around Jefferson City. A telephonic map therefore looks distorted, since inches on the picture are proportional to the price of telephone calls, not to geographic distance. Exhibit 6 shows the telephonic United States as of 1957. It cost \$1.70 to call a thousand miles station-to-station through an operator. There was as yet no option to dial it yourself.

The shaded picture of Missouri describes what aficionados call toll rate disparity. We can see it better in Exhibit 6a. To call a place on the Missouri border from Jefferson City, you pay Missouri state toll rates. In 1957, these were higher than interstate rates. This is shown by the border of the shaded Missouri. With interstate rates, you could reach a point just outside the black (interstate) border of Missouri at less than what it cost to reach a point just inside the shaded border at state toll rates. This example thus illustrates positive toll rate disparity. That's especially noticeable to folks along the border, since it means they pay more to call, say, 25 miles into Missouri than 25 miles into the United States.

By 1971, you could dial it yourself interstate, but not within Missouri. In 1971, the telephonic United States and the toll rate disparity looked like Exhibit 7. It cost \$1.15 to call a thousand miles and a good deal more to call New York than to call Cleveland. Exhibit 8 gives the picture as of 1977 when from Missouri you could dial yourself to anywhere. It's clear that seen from inside Missouri, the telephonic Missouri has grown substantially relative to the telephonic United States. Also it makes little difference now whether you're calling Cleveland or New York.

How come? Exhibit 9 tells part of the same story in different pictures. Between 1971 and 1977 the interstate toll rate schedule went up and changed shape. Most significant is the changed shape. By comparison with 1971, 1977 shows a steeper rise at shorter distances and a flattening at longer distances. The steep rise is what has magnified the telephonic picture of Missouri. The flattening is what has relatively shrunk the rest of the telephonic United States. That flattening is even more pronounced in Exhibit 10, which shows the same interstate rates in constant (1967) dollars.

Exhibit 11 shows how Missouri's State rates also rose and changed shape between 1971 and 1977. Keeping in mind the geographic shape of Missouri shown in Exhibit 12, the effect of the rate change on telephonic Missouri, as seen from St. Louis, is shown in Exhibits 13 and 14. Note especially, how St. Louis' nearest neighbors got pushed further and further away relative to its farthest. This has created a new disparity, about which more in a moment. The details of Missouri's toll rate disparity are evident in Exhibits 15 and 16. From a positive rate disparity in 1971 (at all but distances below 15 miles or so) Missouri went, by 1977, to a much more pronounced mix of negative rate disparity at distances below about 100 miles with positive disparity above 100 miles. Paying more to call short distances inward from the Missouri border than outward to the United States had become a thing of the past, while both state toll and interstate toll prices rose and changed shape.

The steep rise of shorter distance prices may, however, create what might be called an exchange/interexchange priced disparity. In Exhibit 17, note the rise in prices for calling 10 and 25 miles interstate. Where that are local calling areas straddling state borders, this would be noticeable in a steep jump in the price of calling a place just outside the local exchange area over the price of calling a place just within the local exchange area. Exhibit 18 shows that Missouri chose to hold the 10-mile price steady, though clearly conforming to the interstate pattern at 25 miles. This could avoid a steep jump in the price of calling (within the state) a place just outside the local exchange area over the price of calling a place just within the local exchange area.

Exchange/interexchange rate disparities would thus increase pressures for extending flat-rate local calling areas, precisely when competitive pressures and dominant economic wisdom are pressing for usage-sensitive and zone priced local calls. Though the long wars over toll disparity may have wound down, at least for

Missouri, similar battles appear likely to spring up at the exchange/interexchange boundary just in time for the feds to take charge of that border, as envisaged by S. 611 and S. 622.

What administrative and political burdens this may entail becomes explicit when looking—behind the data averaged over all states and beyond the details of a single state—at summary composites of all continental states.

What the preceding exhibits showed in detail for Missouri is summarized for all states in Exhibits 19–22. For 1971, Exhibit 19 shows that 10 states had state toll rates mostly above interstate toll rates and 6 had state toll rates mostly below interstate toll rates for calls to any distance. Two states had pegged their toll rates to the interstate rates. The others, like Missouri, showed complicated criss-crossing patterns with state rates above, at, or below interstate rates depending on the distance called. By 1977 (Exhibit 20), only three states had toll rates uniformly above interstate rates and 11 had gone uniformly below.

All this reflects a complicated amalgam of techno-econo-political change. In 1971 only 17 states had direct dialing. By 1977 essentially all did. And the changing shape of the rate curves, with their steep rise at shorter distances and their flattening at longer distances, could be ascribed to response to competition, to recognition of true costs, to both, or to neither according to the stakes of the arguer. Whatever “true” engineering costs might be, the costs at issue in this legislation are those hitherto determined by jurisdictional separations and envisaged by S. 611 and S. 622 to be determined at the interexchange/exchange border, in accordance with Section 223(c).

I wish to draw your attention, Mr. Chairman, not to the details of disputes over “true costs” and what’s predatory pricing or an unfair burden, but to a great state-by-state rate variability and to the as yet unexamined, so far as I can tell, political and administrative consequences of this variability for the processes envisaged by S. 611 and S. 622. Exhibits 21 and 22 show that while intrastate toll rates have generally migrated downward relative to interstate rates, their variability remains great. I will show this explicitly in the next three exhibits.

Exhibit 23 shows that in Montana you pay a 30¢ toll to talk for 3 minutes during the day to someone 25 miles away. In Mississippi you pay 92¢. Exhibit 24 shows that in the evening Ohio is now on top with 62¢ and Michigan at the bottom with 25¢. At night, Exhibit 25 shows that Ohio still has the most expensive call at 59¢, but Kansas now has the cheapest, at 16¢. I should add that there is equally pronounced state-by-state variability in the book costs of interexchange plant. Hence state-by-state variability would occur under competitive “true” cost-based pricing, though not at all necessarily with the same pattern.

I finally turn to exchange rates. Exhibit 26 shows how basic exchange rates vary around some major patterns. On top, with crosses, are basic business rates. On the bottom, with dots, are basic residential rates. By decades-old custom, basic business rates are roughly twice the basic residential rates. Both types of basic rates generally go up according to the number of other telephones that may be reached within a local calling area. But, around these broad trends, there is again pronounced variability.

I can now make my second major point, Mr. Chairman. It is that each of the states, to make up its state cost pool as it is now defined by jurisdictional separations, now adjusts relative state toll and local exchange prices by its own lights, reflecting its own economic and demographic patterns of both household and business consumers, its own urban/rural balances, and its own regard or disregard of the merits or demerits, powers or weaknesses of the communications suppliers within its borders.

Hence it will not be an easy administrative task either to harmonize or to disassociate state toll and interstate toll rates under the new common interexchange (federal) umbrella envisaged by S. 611 and S. 622. Nor can this task be guaranteed to be devoid of political consequences, since making any change in state toll prices, up or down, will gore someone’s ox or at least prick the skin of someone’s calf. And any change will affect perceptions of the interexchange/exchange rate disparity I have described earlier, hence rock the exchange boat.

Failure to change also implies certain risks. Wide variability in state toll prices may have remained unnoticed by many, or at least accepted by those doing business within many states as one of those peculiar consequences of state sovereignty within our federation. Such variability may be harder for federal authorities to explain and sustain if what are now state toll prices fall under federal interexchange authority. And it may be hard to do away with the variability without a myriad federal/local fights. Such fights are bound to arise over what proportions of exchange costs are to be reflected in local service prices and what proportions are to be charged to interexchange services hence reflected in interexchange prices. As I have already

noted (p. 8), the terms actual cost and relative use in S. 611 have a deceptive clarity. They hide the problem or, at best, they pose it. They surely do not solve it. They have, to reiterate, been the very battlefield of the last 30 years' war.

I close by summarizing my two major points, Mr. Chairman, and making their import explicit. First, I have pointed out that present and prospective competition increases the number of interested parties within the telecommunications, data processing and other supplier industries; it has already increased and promises to continue to increase the awareness and participation of consumers, both household and business; in short, what was a relatively small private club is going public in a big way. Second, shifting jurisdictional boundaries as envisaged by S. 611 and S. 622 will, I think, eliminate much of the buffering that Joint Boards and state responsibility for state toll provided in insulating federal authorities from state-by-state, locality-by-locality accommodations between toll and exchange prices.

The effect is to set up potentially unmanageable federal/local confrontations in arguments grown more complicated and among many more parties than in the past. The extensive procedural detail incorporated in S. 611 and S. 622 may aggravate rather than alleviate this problem. The parties may come to feel hopelessly confined, hence clog the courts and return to Congress time after time for petty legislative adjudications.

I therefore highlight for your consideration the fact that the Van Deerlin bill in the House contemplates leaving a greater buffering role to the states (H.R. 3333; Sec. 324). I also suggest you consider leaving greater administrative discretion to the Federal Communications Commission, within S. 611 or S. 622's explicit guidelines for placing increased weight but not exclusive weight on the marketplace.

The grand design of your "giant handicapping scheme", Mr. Chairman, is appealing. I just wonder whether you also wish to inject the Congress into setting up and administering the detailed apparatus for grooming the horses, taking the bets, paying off every winner, soothing every loser, and shoveling away all the manure. That's what administrative agencies were invented for in the first place.

My colleagues Kurt Borchardt and John C. LeGates explore this problem further in their testimonies. We are at your disposal, and your staff's, for any further light of detail you may wish to have us help shed on it. I thank you.

HARVARD UNIVERSITY—PROGRAM ON INFORMATION RESOURCES POLICY

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 Southern Pacific Communication Co.
 Standard Shares
 Stromberg-Carlson Corp.
 Systems Applications, Inc.

Time Inc.
 Times Mirror
 Transamerica Corp.
 United Telecommunications
 U.S. Department of Commerce:
 National Technical Information
 Service
 National Telecommunications &
 Information Administration
 United States Postal Service
 The Washington Post Co.
 Western Union International, Inc.
 Xerox Corp.

	LOCAL	TOLL	<u>TOTAL</u>
INTERSTATE		11.4	11.4 30%
STATE	18.8 (70%)	8.1 (30%)	26.9 70%
<u>TOTAL</u>	18.8 (49%)	19.5 (51%)	38.3

1346

Exhibit 1: 1976 Telco Cost Allocation(\$billion)

Interstate Spread	Intrastate Spread
\$11.4 billion	\$26.9 billion
5.8 ← → 14.3	32.5 ← → 24.0
-49%	+21%
+25%	-11%

1347

Exhibit 2: Possible Cost Allocation Spread

Present

Proposal

Interstate Toll	}	Interexchange
State Toll		
Exchange		Exchange

State Jurisdiction: Italics

Exhibit 2a: Present and Proposed Jurisdictions

	\$ billion	
Interexchange (federal)	19.5	51%
Exchange (state)	18.8	49%
Total	38.3	100%
		1849

Exhibit 3: 1976 Interexchange/Exchange Proportions

Interexchange Spread	Exchange Spread
<div>\$19.5 billion</div> <div>11.9 ← → 24.4</div> <div>-39% +25%</div>	<div>\$18.8 billion</div> <div>13.9 ← → 26.4</div> <div>-26% +41%</div>

Exhibit 4: Possible Cost Allocation Spread



Exhibit 5: The Geographic United States

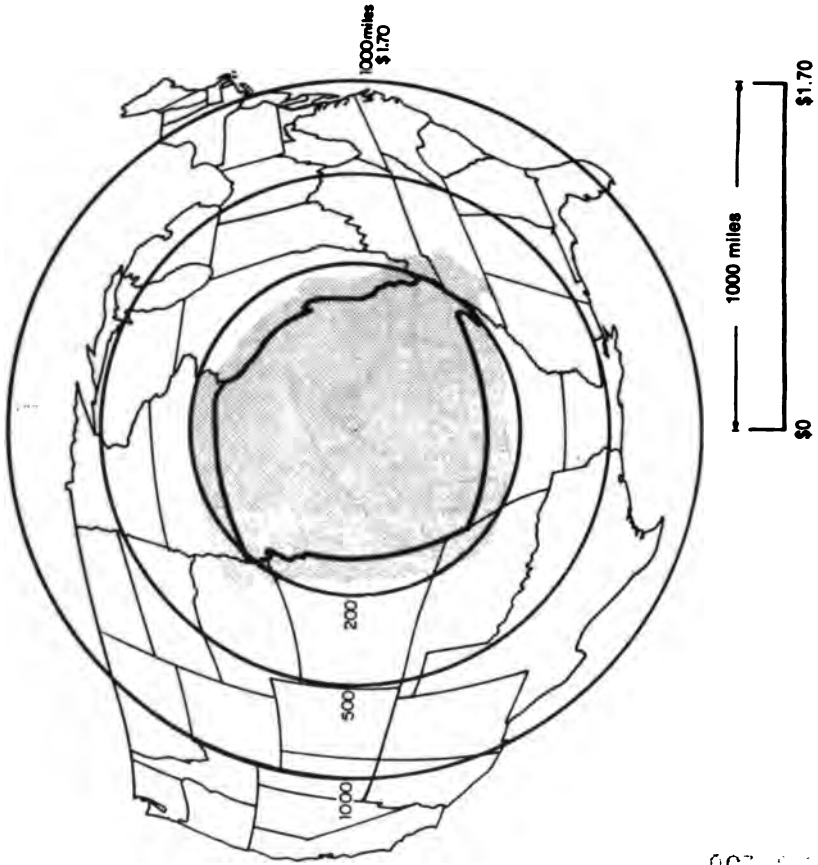


Exhibit 6: 1957 Telephonic United States

OCT 2 1979

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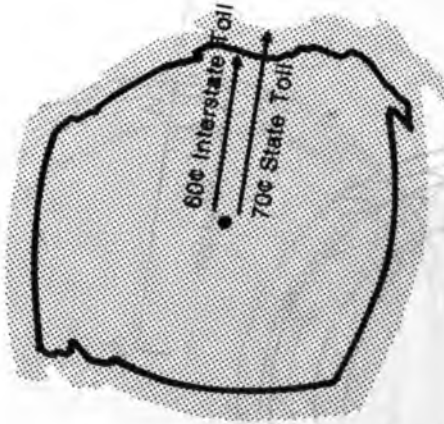


Exhibit 6a: 1957 Toll Rate Disparity

1854

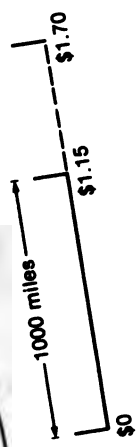
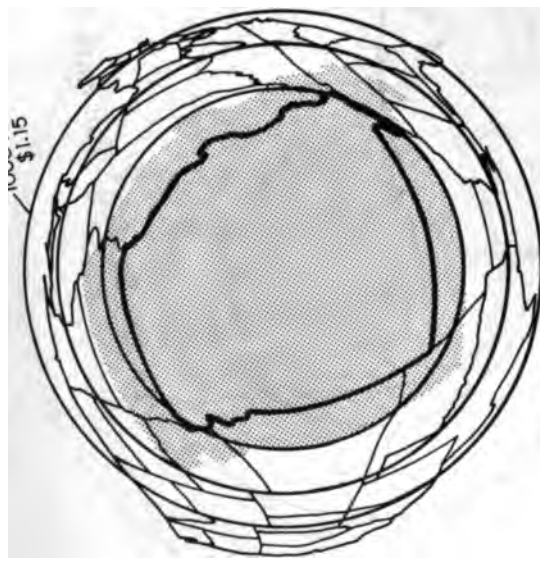


Exhibit 7: 1971 Telephonic United States

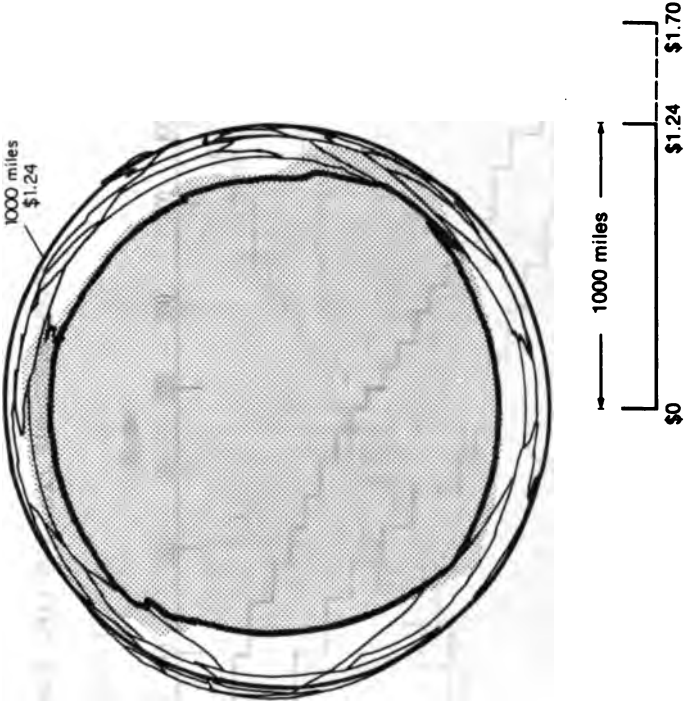


Exhibit 8: 1977 Telephonic United States

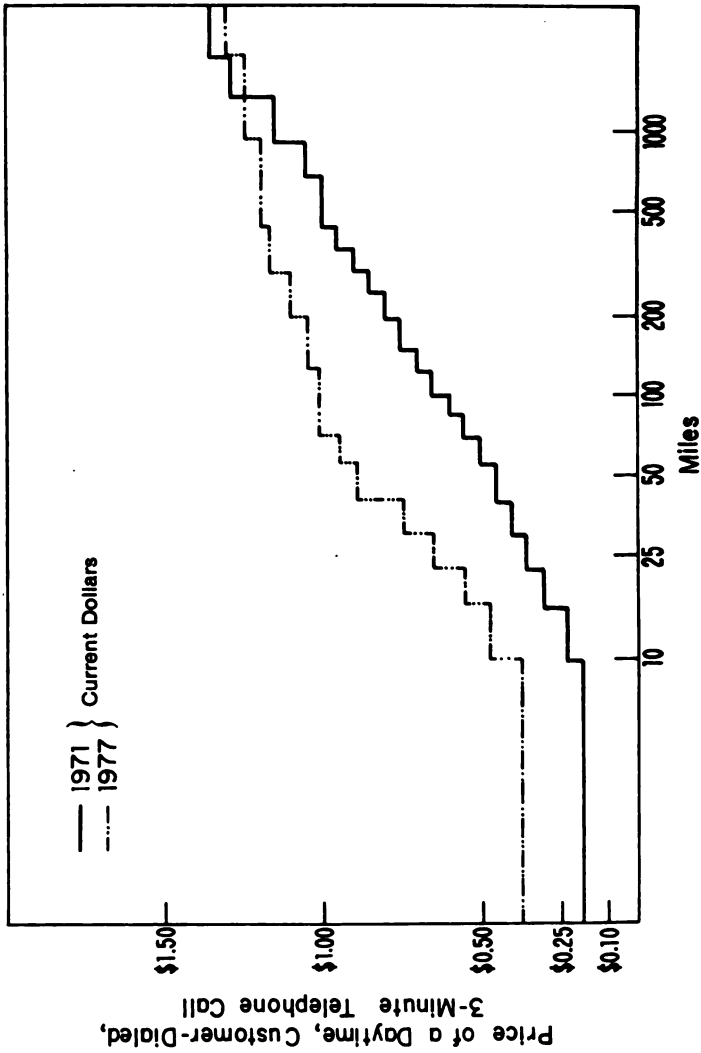


Exhibit 9: 1971 and 1977 Interstate Rates

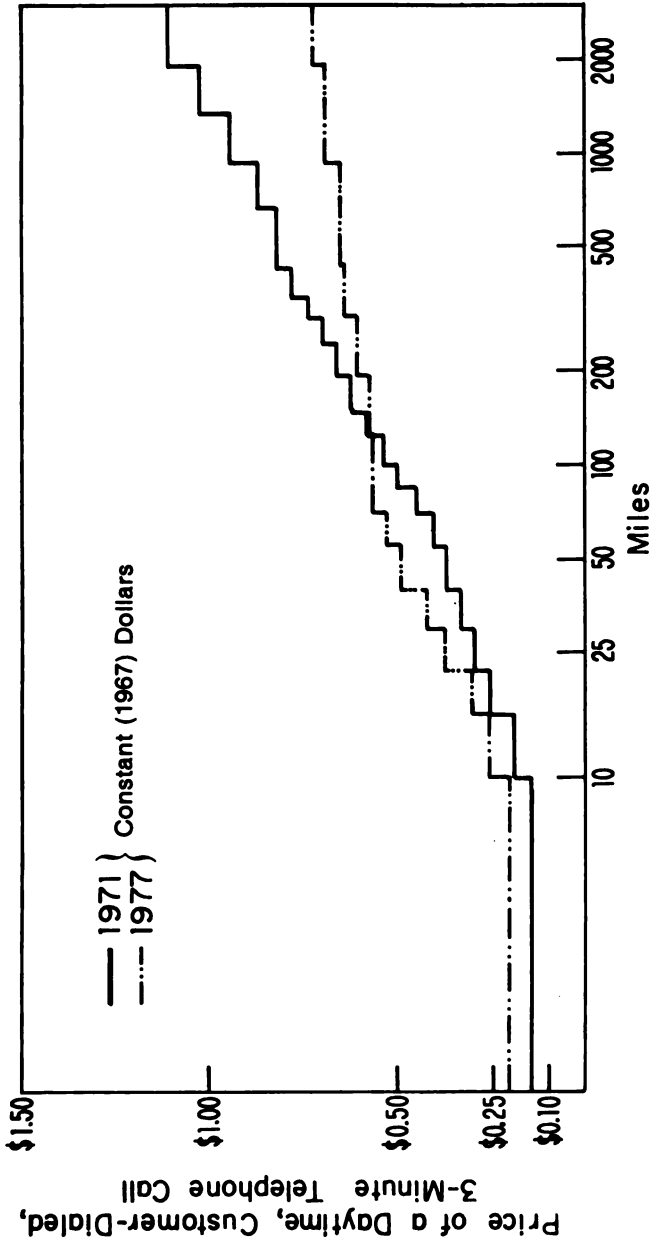


Exhibit 10: 1971 and 1977 Interstate Rates

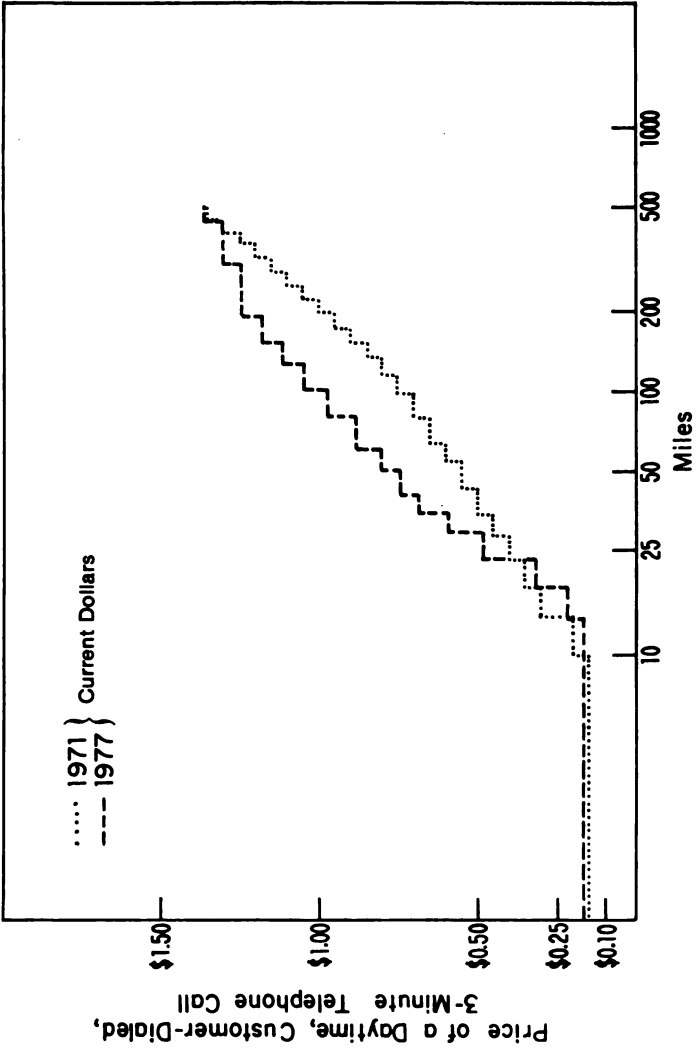


Exhibit 11: 1971 and 1977 Missouri
State Toll Rates

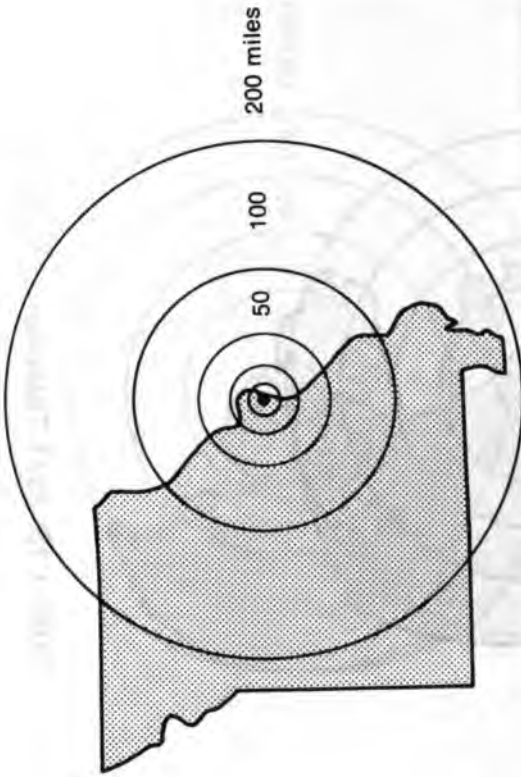


Exhibit 12: Geographic Missouri

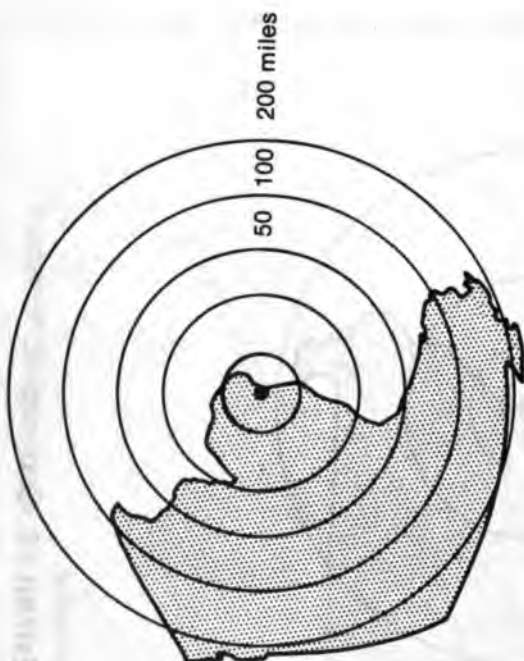


Exhibit 13: 1971 Telephonic Missouri

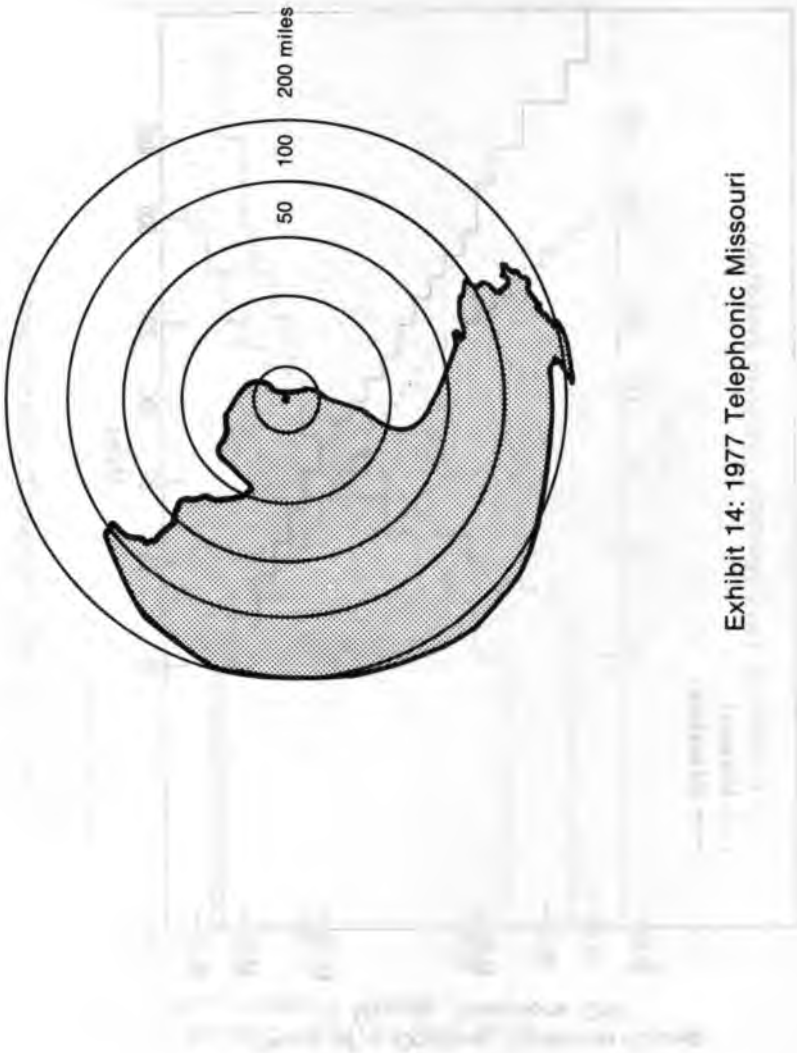


Exhibit 14: 1977 Telephonic Missouri

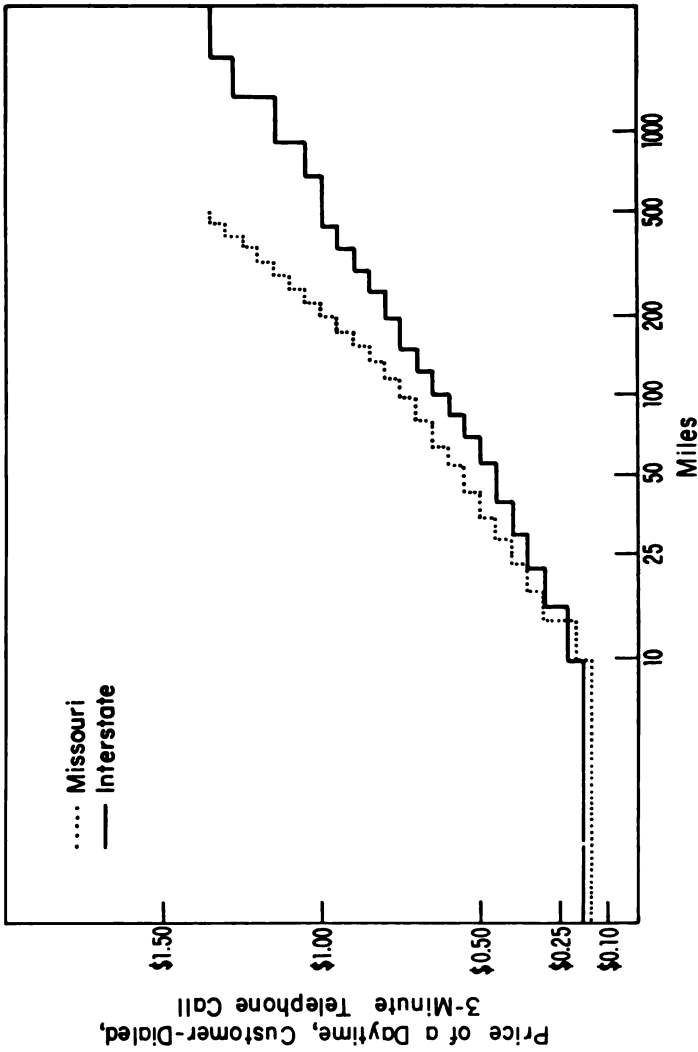


Exhibit 15: 1971 Missouri Toll Rate Disparity

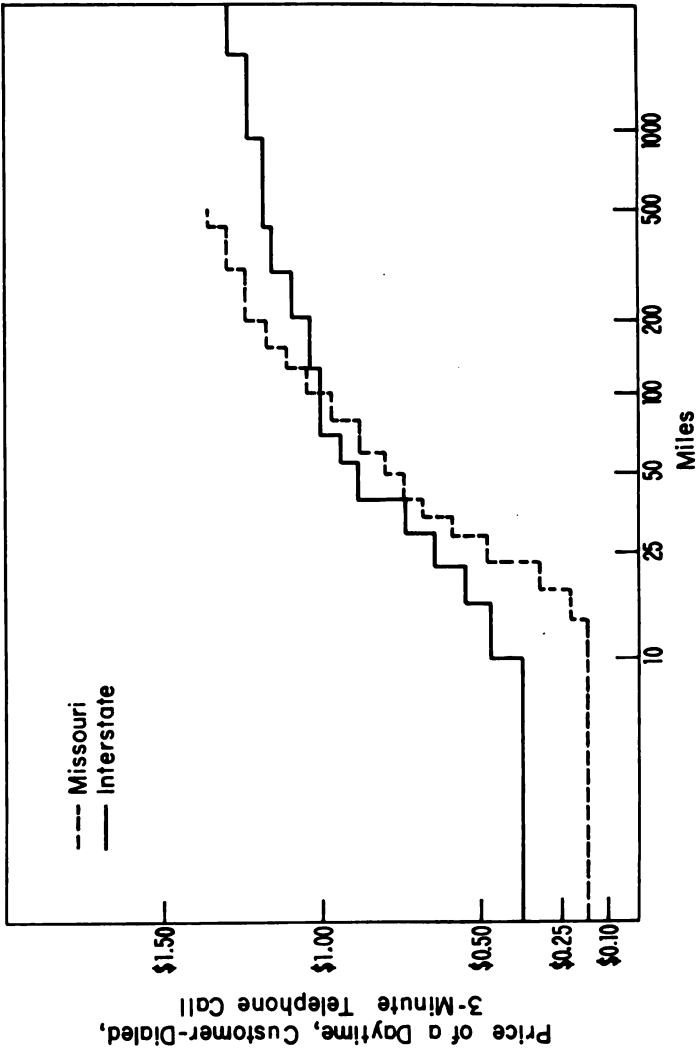


Exhibit 16: 1977 Missouri Toll Rate Disparity

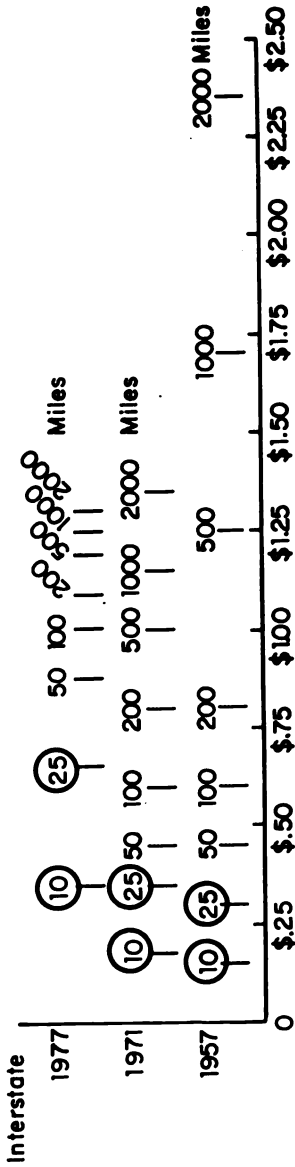


Exhibit 17: The Interstate Short
Distance Price Climb

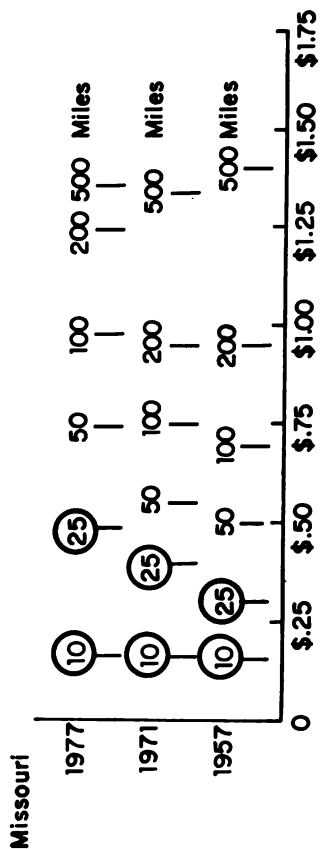
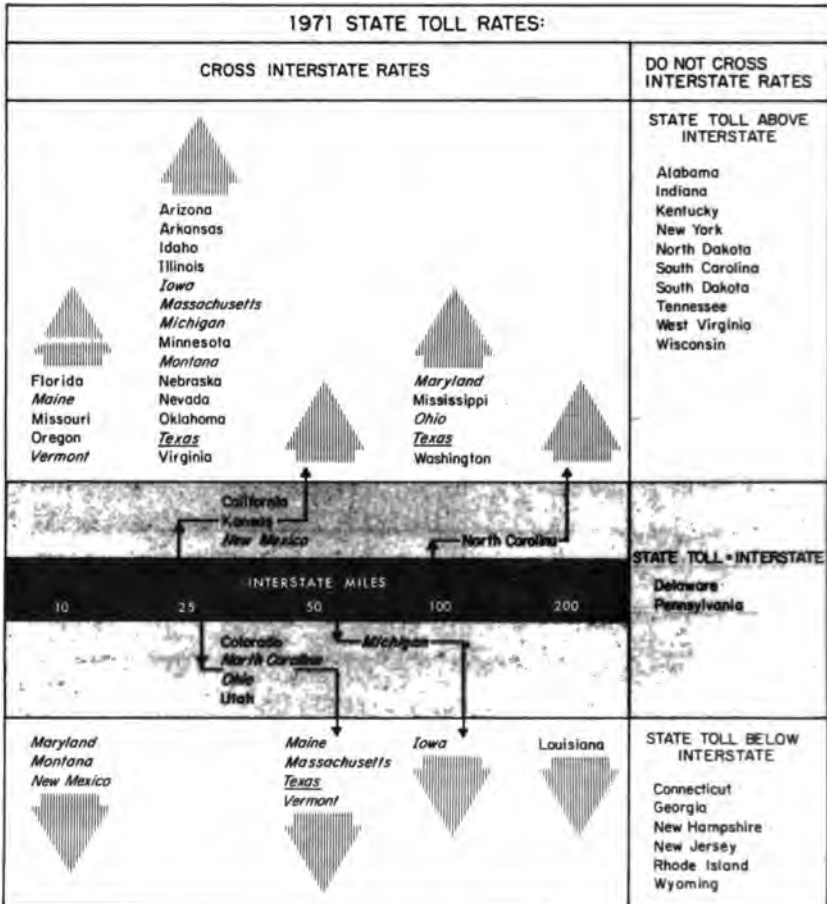
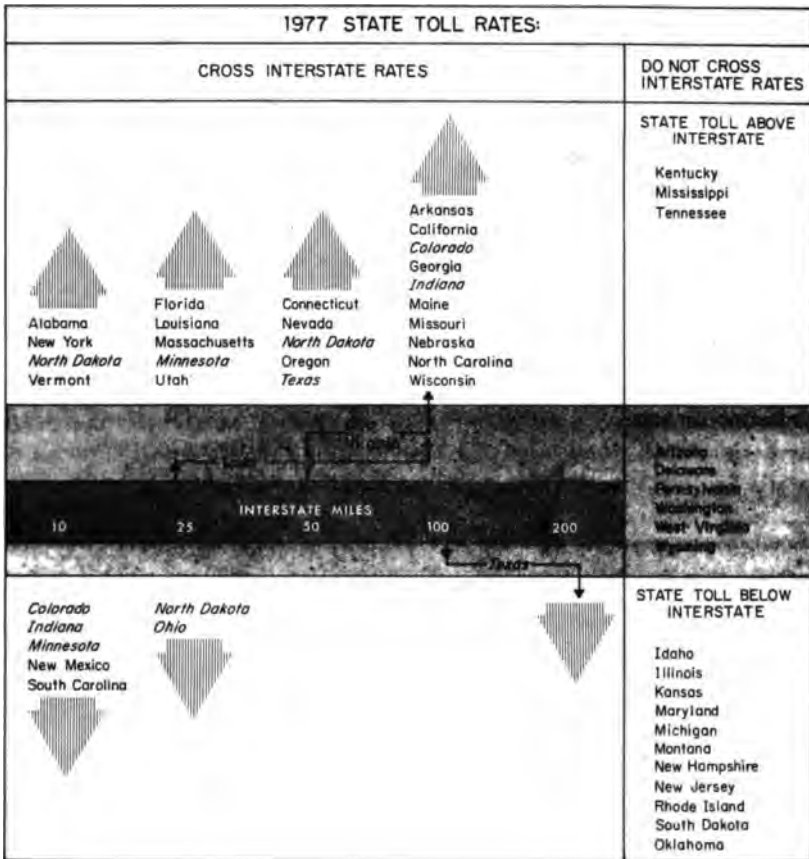


Exhibit 18: Missouri Holds the
10-Mile Fort

**Legend:**States in *italics* cross the interstate rate band twice.States in underlined italics cross the interstate rate band three times. State rates equal interstate rates. Interstate rate band.**Exhibit 19: 1971 Toll Rate Disparity**

**Legend:**

States in italics cross the interstate rate band twice.

 State rates equal interstate rates. Interstate rate band.

Exhibit 20: 1977 Toll Rate Disparity

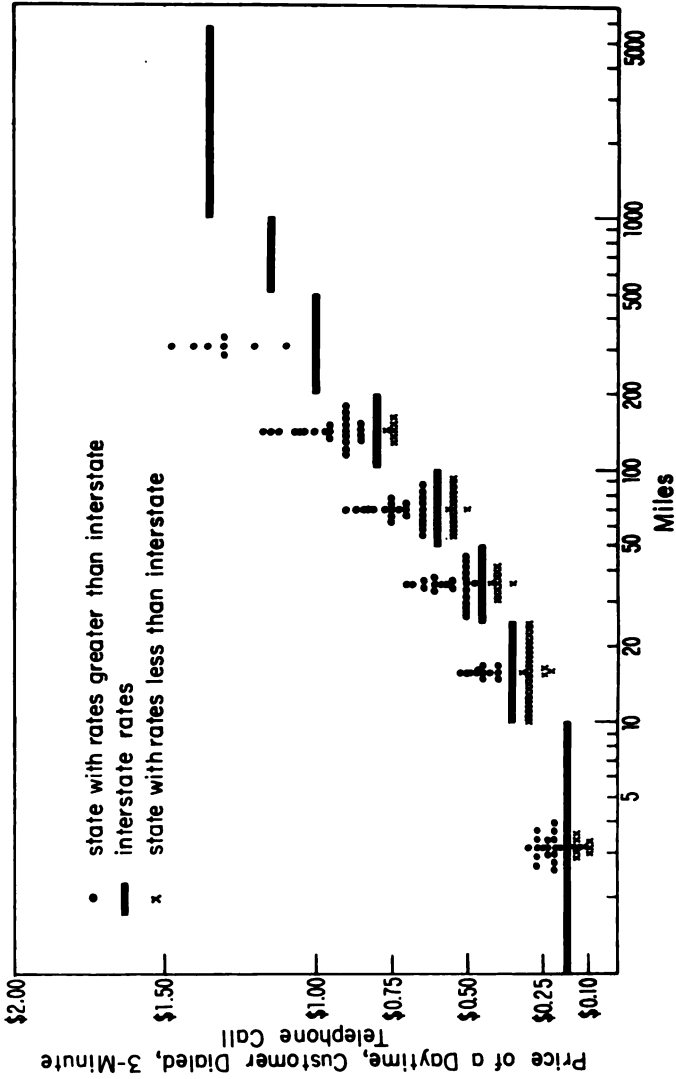


Exhibit 21: 1971 Toll Rate Spread

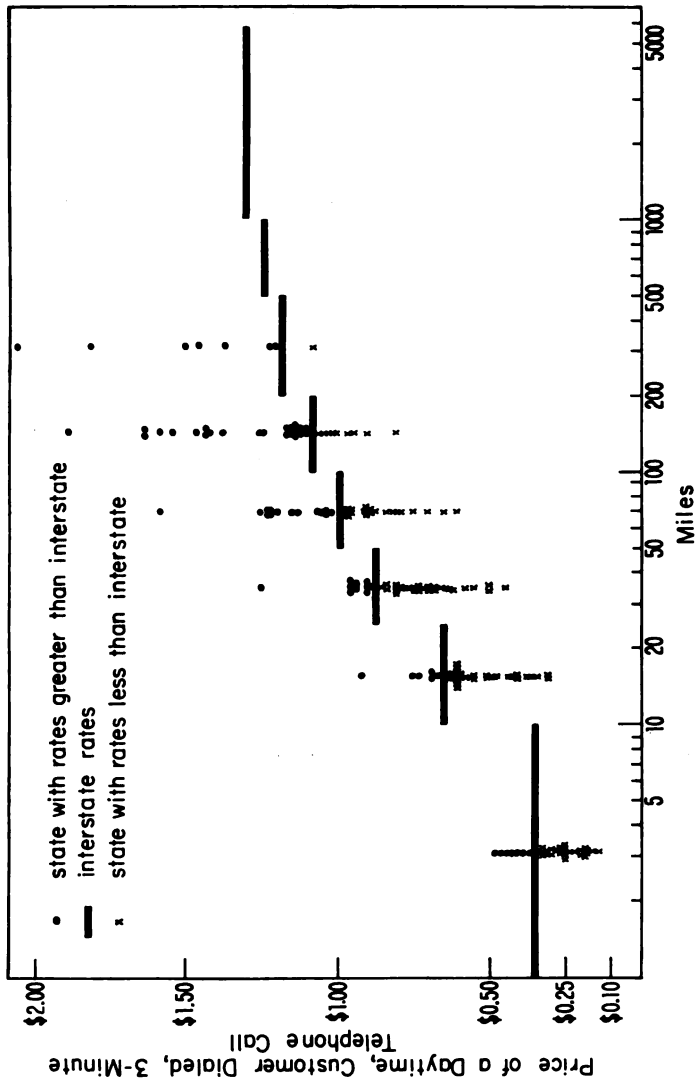


Exhibit 22: 1977 Toll Rate Spread

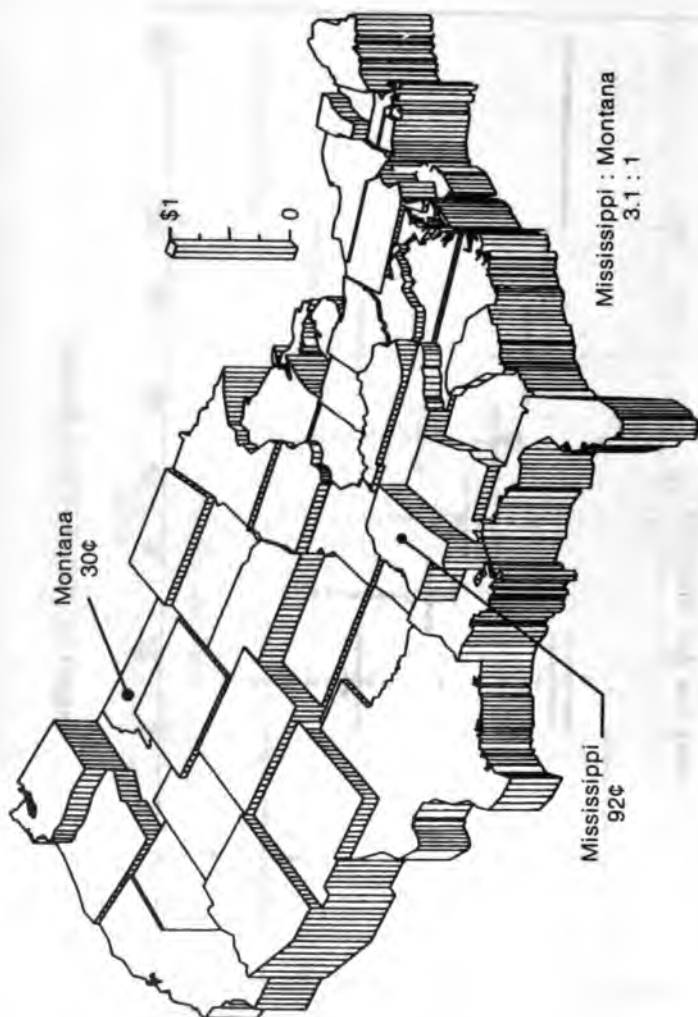


Exhibit 23: State Toll Day Rates,
3 Minutes, 25 Miles (1976)

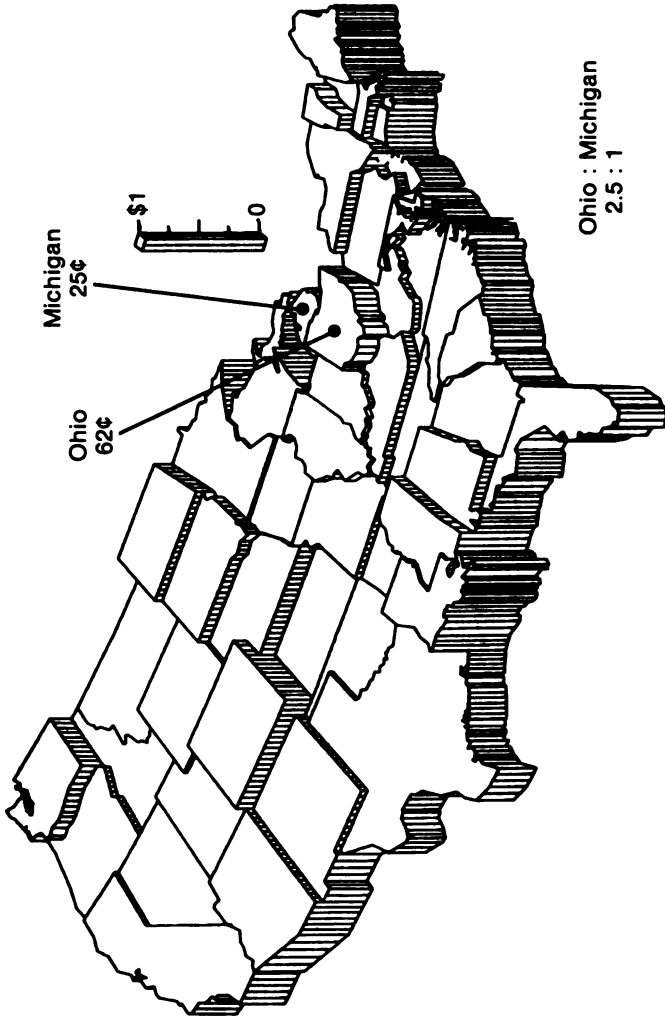
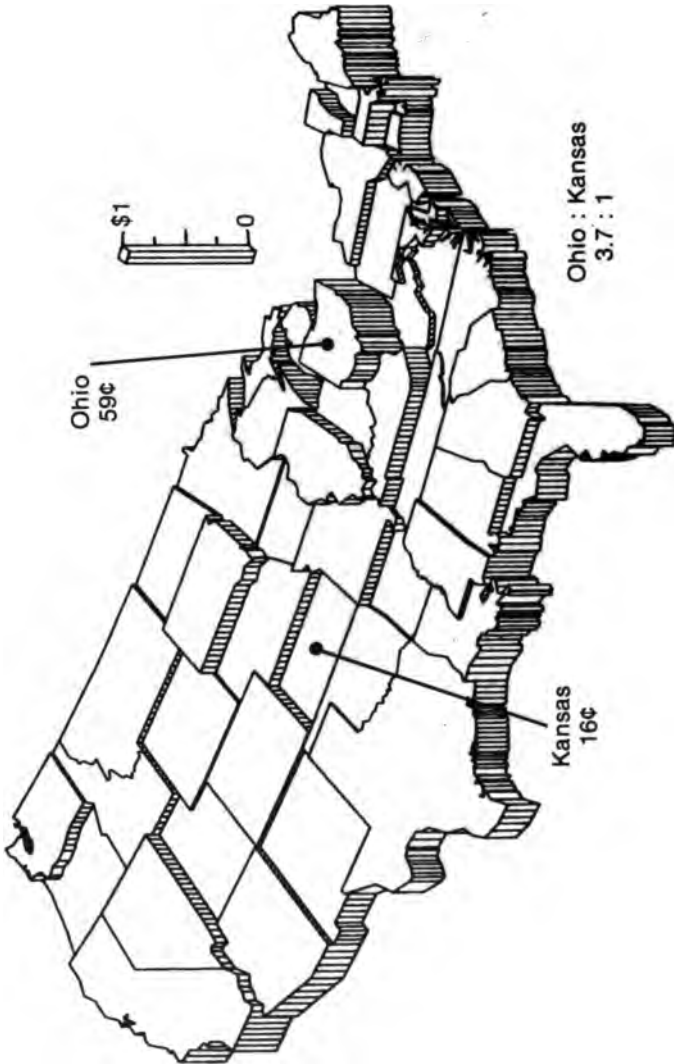


Exhibit 24: State Toll Evening Rates,
3 Minutes, 25 Miles (1976)



**Exhibit 25: State Toll Night Rates,
3 Minutes, 25 Miles (1976)**

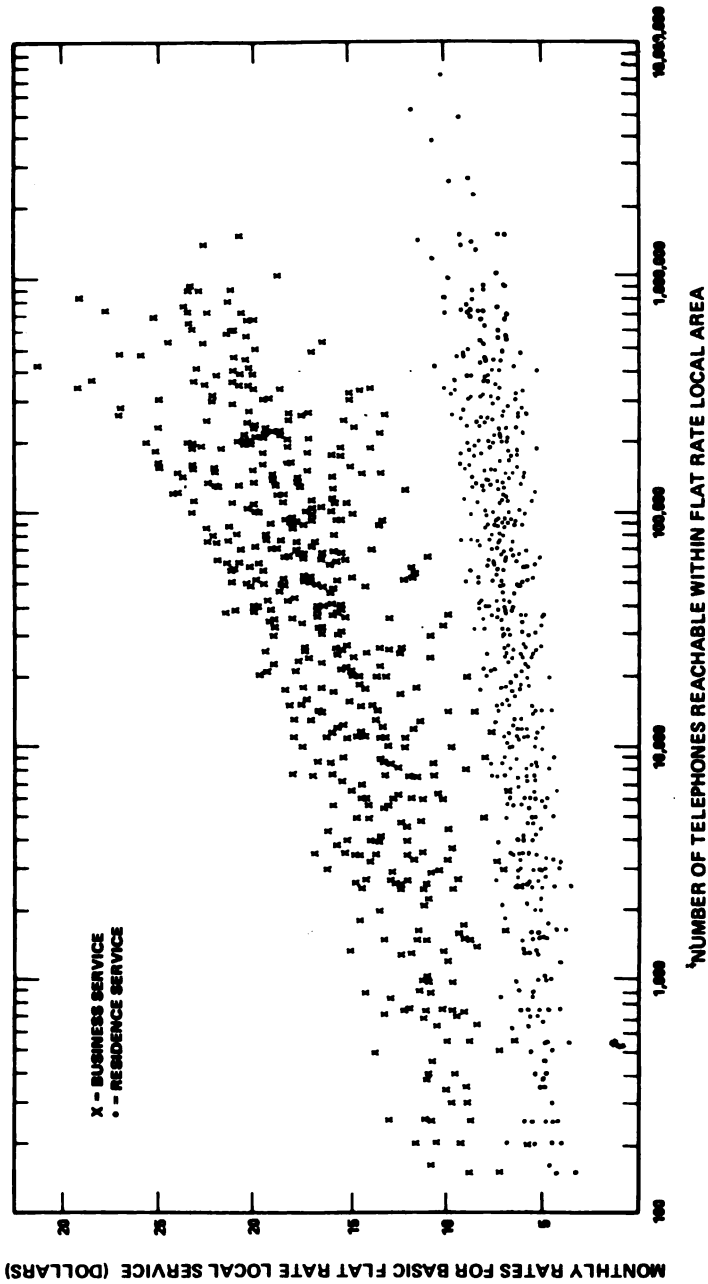


Exhibit 26: Variability in Basic
Local Rates (1974)

STATEMENT OF KURT BORCHARDT, RESEARCH FELLOW, PROGRAM ON INFORMATION
RESOURCES POLICY, HARVARD UNIVERSITY

My name is Kurt Borchardt. For nearly three decades I served as legal counsel to the House Interstate and Foreign Commerce Committee. My responsibilities included but were not limited to communications legislation and legislative oversight of the FCC's regulatory activities.

At present I am a Research Fellow of the Harvard Program on Information Resources Policy. However, the views presented here are my own. I reside in South Carolina, and it gratifying to be that Chairman Hollings and his able staff are playing a leading and very constructive role in the communication and information areas.

My testimony will focus on the Commission-assisted public negotiation provisions of Sections 207 and 210 of S. 611 and the carrier agreement and association provisions of Section 225 (d)(2)(D)(iii) and (d)(2)(H) of S. 622. I want to commend Senators Hollings and Goldwater and their cosponsors for paying attention to processes as well as substantive goals. Just as the medium is the message, the interactive processes between the players who provide communications and information services and the Federal Government are parts of the substance of our information handling infrastructure.

Let me put these interactive processes into a broad perspective:

The emergence of the information handling complex—a whole made up of complicated or interrelated parts—has resulted from the marriage of telecommunication and data processing technologies on the one hand and a blending of monopolistic and free market philosophies on the other hand.

Before the marriage of the two technologies and before the increased reliance on marketplace forces, the Bell System designed, built and operated the domestic telephone system exercising centralized managerial control. The Bell System perceived information handling as an extension of telephony and sought legislation to give it authority to exercise centralized managerial control over an information handling system designed, built, and operated by it (A "system" as distinguished from a "complex" is a regularly interacting or interdependent group of items forming a unified whole" (Webster's Seventh New Collegiate Dictionary, 1963)).

The data processing segment of the information handling complex evolved as the result of marketplace forces which responded to the leadership role played by IBM.

The Federal Government, in an effort to protect the public interest as it perceived that interest, has employed two tools vis-a-vis the telephone system: (1) common carrier-type regulation and (2) antitrust enforcement; it has used mainly the tool of antitrust enforcement vis-a-vis the data processing segment.

With the emergence of the information handling complex, centralized managerial control will not be available to assure the satisfactory functioning of that complex. Will the marketplace forces be sufficient to assure such functioning? Or will a measure of coordination have to be achieved within that complex to assure its satisfactory functioning, and if so, how will it be achieved, and what will be the roles of the suppliers of information handling facilities and services, of the various categories of users of such facilities and services, and last but not least, of the Federal Government?

The information handling complex constitutes one of several infrastructures on which our social, political, and economic systems are built. In order to gain a perspective, we might look at the energy and transportation infrastructures. We might also contemplate in what respects we differentiate between the domestic and the international aspects of the information handling complex; and finally, we might consider how we deal with weapons and space systems as distinguished from infrastructures.

To begin with weapons and space systems, here the Federal Government plays the role of manager viewing the systems primarily as technological phenomena which, unlike the infrastructures, do not directly offer services to the public. The energy and transportation infrastructures offer vital services to the public (or more accurately, to various publics) and, therefore, the Federal Government has demonstrated keen interest in the satisfactory performance of these infrastructures by establishing Departments of Energy and Transportation. Other developed nations have seen fit to have their central governments assume managerial roles with regard to all three infrastructures: energy, transportation, and information handling.

With regard to our emerging information handling infrastructure, the Federal Government finds itself in an ambiguous role; it functions as manager insofar as the national security and the government's own information handling facilities and services are concerned; it has functioned as regulator insofar as the communications segment is concerned; and it functions as monitor insofar as the information handling complex is concerned.

Belatedly, there is recognition in the U.S. that we shall have to create special tools to deal effectively with the international aspects of the information handling complex, and S. 611 and S. 622 contain provisions tending in that direction.

With regard to the domestic aspects of the information handling complex, increased reliance on marketplace forces instead of centralized management raises the question how to achieve coordination sufficient to assure the satisfactory performance of the complex as a whole.

In giving Congressional approval and encouragement in S. 611 and S. 622 to the use by the suppliers of telecommunication services and the Commission of negotiating and associating processes as coordinating tools, the sponsors of these Bills recognize the urgent need for facilitating coordination within the information handling complex.

While this recognition should be applauded, the sponsors might be well-advised to ask themselves the question: Why limit the use of both of these coordinating tools to specific situations such as interconnections, tariffs, and access charges instead of leaving the Commission free, as it is now without legislation, to use these tools whenever it considers such use in the public interest?

Furthermore, a word of caution seems appropriate. Let us not arouse excessive expectations regarding the general effectiveness of these tools. Take, for example, the ENFIA negotiations, which happened to result—fortunately—in agreed interim access charges. The circumstances surrounding the negotiations were exceptional rather than ordinary.

I have attended some of the negotiations, and I have interviewed most of the important participants. My observation is that the success of the negotiations was due largely to a number of factors which may not be present to the same degree in other situations. The factors—not necessarily in the order of their importance—are: (1) Negotiations concerned the stakes of different service providers and did not involve the stakes of user groups to an extent sufficient to warrant their participation in the negotiations. (2) The stakes of the service providers were perceived in terms of more or fewer dollars and not in terms of the justice or injustice of paying access charges. (3) The stakes of the service providers were further limited by being short term ("interim") and not constituting a precedent for the long run ("rough justice"). (4) The players had good and sufficient reasons—though different ones—for wanting to reach an agreement. (5) The personalities of the players' representatives, the Commission moderator, and other participants were well-suited in terms of credibility, patience, sense of humor, and sense of proportion to the task of negotiating and bargaining in an attempt to reach a reasonable compromise.

What might we conclude from these observations? I suggest we might conclude that successful public negotiations with Commission assistance will be the exception rather than the rule and that we should be cautious not to raise excessive expectations that this tool will go a long way in replacing adversary processes when it comes to achieving coordination between contending players within the information handling complex.

As we move from a Bell designed, built, and operated telephone system to an information handling complex, we may have to pay the price of achieving coordination within that complex through an increasing number of adversary proceedings in lieu of private and intra- and inter-company negotiations and agreements which constituted an important management tool within the Bell-managed telephone system.

Negotiations and associations for purposes of coordination will be valuable tools wherever these tools may be used to advantage, though the occasions for their use may be infrequent. The Commission should be given ample leeway as it has been in the past to use these tools whenever it deems this appropriate in the public interest.

STATEMENT OF JOHN C. LEGATES, DIRECTOR, PROGRAM ON INFORMATION
RESOURCES POLICY, HARVARD UNIVERSITY

Mr. Chairman, my name is John LeGates. I am Director of the Program on Information Resources Policy at Harvard University and President of the Center for Information Policy Research, a companion non-profit organization.

Our purpose is to examine the changes taking place in the information industries with the aim of usefulness to government, industry and the public. We are supported by approximately seventy organizations, many of whom compete and conflict. Two documents describing our work are appended. The opinions expressed here, however, are my own.

I read both S. 611 and S. 622 as aiming to identify and classify distinct facilities and services, to isolate them into separate accounts and, in some cases, to divest

them into organizational entities without common financial structure, facilities or personnel.

However great may be the virtue of simplicity in what S. 611 terms "full separation", one thing is clear. That is not where we are today. Joint and common costs abound in the telephone companies, and in the competing industries as well. Virtually every kind of competitor with the telephone system also has them. This is true of the computer industry, the data processing industry, the companies making terminals, modems and interface devices, and the small and large competitors in the interexchange transmission business.

The bills provide for a transition. This will involve a process, apparently applicable to Category II carriers but not to competing industries with joint and common costs, of classifying facilities and services, separating accounts, and maybe separating organizations.

I submit that pushing this task too far too fast is both impractical and undesirable. It could involve administrative nightmares, direct damage to affected industries, and the prospect of permanent inefficiency.

Let me begin with administrative nightmares. I see these as arising from two activities: the classification of services, and the allocation of joint and common costs.

These activities have something in common—a lack of definitional clarity.

An example of lack of clarity in classification is afforded by the FCC's two "Computer Inquiries". These have addressed the problem of finding a distinction between "computing" and "communications". Failure of the first inquiry to produce a satisfactory working definition led to the second inquiry. This is still in progress after almost three years. I think that the problem is neither intricacy nor ineptitude. The problem is that there is no inherent difference between the two. Distinctions, if they must be made at all, will be arbitrary, or will be based on current offerings. Arbitrary distinctions tend to break down upon application; those based on current practice refuse to hold still.

Some, possibly most, of the services, functions, and capabilities up for classification present the same problem—there is no inherent distinction. If distinctions are made, then services will crop up which fail to fit. If the classifications are enforced, they could freeze an industry whose dynamism is a strong virtue.

Any classification of services, functions, and capabilities or any allocation of costs will benefit some parties and harm others. Those who are harmed will defend themselves. They will have a strong weapon: the lack of definitional clarity. There will be appeals to the FCC and, as has been the growing trend, to the courts. The possibilities for tying up progress on claims and counterclaims are almost endless.

Lack of clarity in allocating joint and common costs arises from the fact that these are arbitrary and indeterminate on purely economic grounds, especially in the absence of perfect competition. Additional assumptions must be made. In this industry these assumptions have been and are now determined by political accommodations within the framework of statutory and case law. Tony Oettinger explores this in detail.

The only way to avoid arbitrariness in allocating joint and common costs is by complete separation of capital and labor for every facility, service, or function. Carried to the extreme, this would create a fragmented industry made up of small companies. Many would be operating close to the margin to keep ahead of the competition. Such an industry would be unlikely to offer coordinated services, or to accumulate the cash necessary for major technological breakthroughs.

The possibility for direct damage to the industry lies in breaking up entities. The Hollings bill (Sec. 205(d), p. 31ff) requires separation within 180 days of enactment for certain classes of service and facility. It appears to require divestiture of Long Lines from AT&T. It also appears to require divestiture of intrastate, interexchange services from Bell operating companies. Likewise with MTS and WATS. It would appear to require breaking up Southern Pacific Communications Corporation by virtue of its SPRINT service, and MCI by virtue of its EXECUNET service. It may make ATT's Advanced Communications Service, or anything like it, illegal for any offerer.

Some of these divestitures are probably contrary to the intent of the bill, as they would damage entities who are already underdogs in the competition. Others may retard the development of desirable services. Still others, because of the timing if nothing else, will weaken existing services before the competitive environment has produced a replacement.

The prospect of permanent inefficient stems from a problem built into "full separation". Full separation is incompatible with economies of scope. Economies of scope, different from economies of scale, are achieved by doing more than one job with one resources. Using the same handset to make both local and long distant calls exemplifies economies of scope.

It can be argued that the economies built into a competitive environment are greater than economies of scope. The answer to that question is not known. What is known, however, is that some separations can only be made at the expense of economies of scope, and that the possibility of permanent inefficiency is present whenever this happens.

We can now construct a restatement of the whole issue of separating entities. The issue is "how far can we separate entities to encourage competition without becoming bogged down in administrative swamps, doing direct harm to the existing system, or losing more through loss of economies of scope than we gain by competition?"

The bills each deal with separation of entities at three levels: classification, accounting separation and organizational separation.

The Hollings bill classifies all carriers as Category I or Category II depending on the degree of effective competition (Sec. 204(a), p. 26ff). To determine the degree of effective competition, the FCC "shall define and establish by rule generic classes and subclasses of telecommunications services based on relevant distinctions as to the primary functional telecommunications capability provided to the user and the degree of substitutability between and among comparable services." The Goldwater bill (Sec. 225(d)(2)(A)) eliminates this step, and classifies only by degree of competition. Both bills call for ongoing review of the classification.

The Hollings bill stresses classification by service, but also adds two other criteria: functions, and capabilities, the latter being open to interpretation as "facilities". The classification by services could be an administrative swamp, as suggested above. Adding functions and capabilities makes it worse. The bill avoids the FCC Computer Inquiry's unsolvable problem by avoiding service, function and technology criteria altogether, and classifying only by degree of competition. A logical and consistent follow-through would be to avoid these criteria elsewhere as well, and adopt the Goldwater bill's approach of going directly to degree of competition.

Accounting separation is specified in both bills, with heavy reliance on allocation of costs among different services. The Hollings bill specifies (Sec. 220(a), p. 49) "such guidelines shall be designed to accomplish a complete accounting divestiture of competitive services of such carrier." The Goldwater bill requires the Commission (Sec. 201(d)(2)(B), p. 9) "to allocate costs of service provided in order to ensure that in any case where telecommunications products or services are provided by a carrier which also provides the monopoly service, revenues and costs attributable to the provision of monopoly service and all other services may be properly identified."

Like classification, cost allocation poses administrative difficulties because of the lack of underlying logical distinctions. Distinction can only be achieved by separation of entities. Although entity separation has a logical advantage over accounting separation, it also has an enormous practical disadvantage—it precludes economies of scope. Both bills may be setting in motion a process which will harm economies of scope to achieve cost allocation. A specific prohibition against using entity separation as a tool to achieve accounting separation would be beneficial.

Both bills deal with entity separation. The Goldwater bill allows it as a tool "to accomplish policies" (Sec. 201(d)(2)(C), p. 10). The Hollings bill goes farther, and requires entity separation through a series of specific prohibitions (Sec. 203, p. 22, and Sec. 205(d), p. 31). These prohibitions rely on the definition of "fully separated entity" (Sec. 103, 11, p. 6) which requires not having "common directors, officers, employees, or financial structure or commonly owned facilities. . . ."

These provisions of the Hollings bill are powerful. They deal specifically with services which make up a large part of the existing industry, and they specify a degree of separation which requires separation of plant. The language does not contain adequate safeguards to prevent damage to economies of scope. There would be less potential for harm if these separations were required only after accounting separation had failed to do the job, and when the harm to economies of scope could be balanced by a compensating good, such as the economies of effective competition.

In summary, I am recommending that the classification of entities by service, function, or capability be avoided where possible, that accounting separation be used instead of entity separation to avoid harming economies of scope, and that entities not be separated until there are alternative competing entities.

I thank the committee for the opportunity to express my views.

Senator HOLLINGS. Mr. Knecht.

Mr. KNECHT. Thank you, Mr. Chairman.

I am Louis B. Knecht, secretary treasurer of the Communications Workers of America.

Our president, Glenn Watts, sends his regrets about not being able to testify because of a longstanding commitment.

We have filed our detailed statement with the subcommittee. Therefore, to save your time, I will summarize our views on S. 611 and S. 622.

In view of the competition that has entered the domestic telecommunications industry, we share the view that the 1934 Communications Act needs updating.

We are concerned about the competition which, up to the present, does not serve the ordinary telephone users but benefits business customers, generally the larger ones.

So far, the only tentative benefit for the ordinary user is the ability to buy one's own equipment. We want the consumer to be exercising a fully informed choice, which includes knowing they are assuming responsibility from the telephone company.

We still believe end-to-end service responsibility with rate-leveling is in the best interest of the ordinary consumer. We are pleased that S. 611 includes authority for the FCC to require country of origin labeling on imported equipment.

Last year, we were unsuccessful in getting the Commission to adopt such rules in the part 68 terminal equipment registration program. Recently the Commission adopted similar rules for equipment covered under other parts of the FCC rules.

We will file our petition again for part 68 modification. As the subcommittee is aware, we were the moving force behind the baseline study on terminal equipment, undertaken by the U.S. International Trade Commission.

The final ITC reports show about 17 percent of the interconnect market is of foreign origin. We are concerned because our union represents about 150,000 American men and women whose jobs are directly connected in one way or another to terminal equipment.

We have seen too many jobs exported in radio and TV manufacturing. We don't want the same to occur in telecommunications equipment.

From the viewpoint of our members' interests, we ask that your legislation not require establishment of separate subsidiaries within the A.T. & T. and other telephone companies.

The provisions on separate subsidiaries and maximum separation are silent as to employee protection. When employees whom we represent will be transferred into a newly formed unit, we can see many complex pension entitlement, wage, and benefits questions unresolved, after such major structural changes.

We will be making specific proposals on employee protection for your consideration. We prefer accounting and other structural safeguards to allow telephone carriers to compete on equal terms and prevent cross subsidies.

In asking for employee protection provisions, we want to stress that we are also concerned about those men and women employed by interconnect companies and specialized carriers, most of whom we don't represent.

As we understand both S. 611 and S. 622, the FCC would be able to retain jurisdiction if the contemplated benefits of deregulation don't develop. We hope the legislation your subcommittee reports will allow the FCC to retain and reassert jurisdiction if necessary.

Since some of the actual and potential competitors of A.T. & T. will be very large corporations such as IBM, ITT, Xerox, and probably Exxon, we are concerned about legislating a shelter or handicap system.

These large companies don't require such discriminatory protection. For a long time, we heard the term "cross subsidy," applied solely to A.T. & T., either as an allegation or potential threat.

We hope the subcommittee will look at these other large corporations because we can see they also might be able to cross subsidize.

S. 622 contains some privacy protection provisions, applicable to CATV systems.

We urge the subcommittee to look at the privacy protection problems of today as set out in the April 3 Presidential message.

We would want tighter privacy provisions to cover all telecommunications. Mr. Chairman, I think that is the proper reference to the question raised by Senator Goldwater as he left regarding his wanting to hear our further views on the privacy matter.

That reference to the April 3 Presidential message is such that we would want you to know we are in complete agreement with what the President suggested in that message.

In addition, in the last—no, not in the last Congress—in the 94th Congress, a bill was introduced on privacy which didn't pass and it contains our thoughts relating to the privacy matters touched upon by Senator Goldwater, and a copy of that bill has been furnished to Mr. White of Mr. Goldwater's staff.

Both Senate bills call for network access charges to help support local exchange services at what we hope will be affordable rates.

The recent ENFIA agreement represents an equitable means of settling the long-simmering disputes among carriers. We can support the inevitable deregulation of terminal equipment, provided there are no hobbles placed on the competitors.

Since carrier interconnection would be mandated by both S. 611 and S. 622, we support an open process for planning and management, with the hope that the responsibility to the user will not be diffused.

On international matters, we prefer to leave Comsat as originally designed to be a carrier's carrier.

An executive branch agency, such as the National Telecommunications and Information Administration, should be the entity to coordinate the U.S. interest in dealing with foreign correspondent carriers, most of which are parts of their governments.

Thank you.

[The statement follows:]

STATEMENT OF LOUIS B. KNECHT, SECRETARY-TREASURER, COMMUNICATIONS
WORKERS OF AMERICA, AFL-CIO

Mr. Chairman, the introduction of S. 611 and S. 622, together with H.R. 3333, strongly indicate to us that the Congress is coming very close to enunciating a new national telecommunications policy. We share the view that an updating of the statutory framework is appropriate, in view of the extensive and unforeseen advances in technology since the 1934 Communications Act was adopted and in view of the decade-old competitive impetus in what had been a monopolistic industry.

To the extent that competition actually can serve the interests of the user, we are encouraged. In both pending Senate bills, we have some areas of concern and opposition. Up to the present, we have seen that the competition in terminal equipment and intercity service offerings has benefited only the business customer, and generally the larger businesses. The ordinary telephone user's single possible—

and tentative—benefit is the ability to buy one's own equipment. As we have testified a number of times, we want the consumer exercising this choice to do so on a fully informed basis; we want this consumer to know that buying one's own telephone instrument means assuming from the telephone company the responsibility for that terminal equipment.

For quite some time we have believed that end-to-end service responsibility with rate-leveling was in the best interest of the ordinary consumer. We see many of the competitive forces working counter to that idea.

We are pleased that you have included a new Subsection 203(d)(2), under which the Federal Communications Commission may require nation of origin labeling information equipment registered under Part 68 of the FCC's rules. Last year, we petitioned the FCC to require this kind of information; our petition was denied. We are aware of the statutory requirements on this line, as well as the Commission's recent Report and Order in Docket 20790 on equipment covered in Parts 2, 15, 18 and 83 of FCC rules. These new rules specify that country of origin markings must be irremovable. We have found that some of the imported telephone equipment on the market bears easily removed labeling—stickers or ink. Since the FCC has moved in Docket 20790, we intend to file again for Part 68 rules modification. We believe the consumer is best served by knowing where the equipment on the retail store market originates.

As the Subcommittee is aware, CWA was the moving force behind the "baseline study" undertaken by the U.S. International Trade Commission about a year ago on the extent of imported telecommunications equipment in the American market. A representative of CWA testified at the September 26 hearing of the Trade Commission. The final report of the ITC established that about 17 percent of the telecommunications equipment in the interconnect market is of foreign origin. Annex "A" to this statement is a reproduction of page 6 of the March 1979 issue of the trade journal "Inter-connection," which apparently contradicts some of the representations of the North American Telephone Association at the ITC hearing. The trade journal article notes that "NATA hopes to head off Congressional enactment of some kind of protectionist measures, most likely tariffs, which would substantially increase the cost of imports. This would, of course, damage the competitive position of interconnect companies that rely heavily on imported equipment."

We fully intend to maintain our pressure on the appropriate Committees of the Congress during the pending examination of the Multilateral Trade Negotiations package. We make no secret that we fully intend that imported telecommunications equipment be given whatever tariff and quota treatment is necessary to prevent the further export of American jobs. Our Union represents approximately 150,000 American men and women whose jobs are directly connected in one way or another to terminal equipment. We have already seen that radio and television receiver manufacturing has gone overseas; we are confident no one on this Subcommittee or in the Congress wants to see the same events overtake the telecommunications equipment industry.

The Subcommittee is now aware that the Japanese MTN negotiators have flatly refused to open the government-sponsored Nippon Telephone & Telegraph Public Corp. For full, open outside bidding; thus, Ambassador Robert Strauss has let the Japanese know that the United States will hold to the same stance, in our government procurement.

We must ask that your legislation not require establishment of separate subsidiaries within the AT&T and other telephone companies, from our own members' interest viewpoint. We are concerned about separate subsidiaries because the proposed bills contain no hint of employee protection. When employees whom we represent would be transferred from a unit with which we bargain to a newly formed unit, we can see many complex pension entitlement, wage and benefits questions unresolved. Accordingly, we will be offering proposals on the subject as a new section in title II. We have used as models 4 Acts of Congress: Section 222 of the present Communications Act, added in 1943; the Railroad Revitalization and Regulatory Reform Act of 1976; the Rail Transportation Act of 1976; and the Airline Deregulation Act of 1978. We would intend that these employee protection provisions include the men and women now employed in the interconnect industry and the specialized common carriers, most of whom we do not represent. We believe that a more equitable and less cumbersome treatment of telephone carriers calls for a greatly improved accounting and allocations system and necessary structural safeguards. And specifically in view of the "maximum separation" impetus of S. 611, in domestic and international carrier operations, we would find a statement of Congressional concern on employee protection most apt.

Recently, Chairman Hollings was quoted in the trade press about the benefits and problems associated with the recent deregulation of the airlines. Quite properly he

noted that the telecommunications system cannot be allowed to develop similar service disruption problems. We are not yet hailing the success of airlines deregulation, because we do not think there is enough experience. Already, airlines have given strong indications they will squeeze down on numbers of flights and communities served; the cheap "out" for some is to suggest that "feeder" airlines will rush in to provide the service. Perhaps. But, we are beginning to see indications that many of those "bargain" air fares are beginning to disappear, now that the first exciting phase of airlines deregulation is ending.

We are perceiving some blurred signals. We hear many expressions of concern over "bigness" as bad per se, when applied specifically to AT&T. Thus it is somehow good for the competition to be fostered, by public policy. While AT&T is not in the "Fortune 500" industrial list, it leads Fortune's "Top 50" utilities. But from the "Fortune 500" list we certainly can find many of AT&T's competitors, actual and potential. For example, we can find Exxon as No. 2—and with oil deregulation, we can expect it to be No. 1 reasonably soon. We find IBM as No. 7, ITT as No. 11, Xerox as No. 39. RCA is No. 30, CBS is No. 91 and ABC is No. 152; while these last three are the dominant forces in broadcasting, they are still listed in the 500 industrials. Southern Pacific is No. 7 in the "Top 50" transportation companies. Thus, we are not seeing a few small-time operations trying to stave off bankruptcy in contention with AT&T and other telephone carriers. It is our position that the telecommunications industry of this nation is far too vital to be left to the untrammelled desires of megacorporations. Someone—that means the national government—must continue to hold the powers to ensure that the user is served by the entire industry. Diminished regulation, with retained powers at the FCC, would be a more cautious and sensible middle ground between today's tight regulation and no regulation at all. We would urge that the legislation reported out of this Subcommittee allow the FCC to retain and reassert regulatory jurisdiction as found necessary. As we understand both S. 611 and S. 622, the Commission would be able to retain jurisdiction, if the contemplated benefits of deregulation do not come about. We ask that this consideration be clearly addressed by the Subcommittee. Further, we are very concerned about legislating a "shelter" or "handicap" system, whose effect in our view would be to protect the Exxons and IBM's and ITT's of this world. We view such proposals as discriminatory.

We have heard for a very long time the term "cross-subsidy," applied solely to AT&T as either an allegation or a potential threat. We would welcome this Subcommittee's investigations of the "cross-subsidy" possibility in the competitive communications operations of IBM, Xerox, ITT, Southern Pacific, Exxon and others; in our view, it is the extreme of naivete to believe these other megacorporations are unable, unwilling and devoid of incentive to cross-subsidize. We do not find clear authority for the FCC to investigate and control cross-subsidies set by other than the "Category II carriers," which mean AT&T and other telephone carriers. We cannot see equity toward the user or telephone carriers, unless the matter is sufficiently broadened or clarified.

S. 622 includes provisions on privacy protection as a new Subsection 335(k), applicable only to CATV system. We urge the Subcommittee to look closely at the privacy protection problem of today, which was recognized in the April 3 Presidential message to the Congress on "The Right to Privacy." Since the Congress last year adopted the Foreign Intelligence Surveillance Act, we see an opportunity for the Congress now to move to cut back severely on other practices of eavesdropping and invasions of privacy through telecommunications systems. We do not view the putative safeguards in Title III of the 1968 Omnibus Safe Streets and Crime Control Act as effective; unfortunately, there have been many indefensible abuses of Title III powers to conduct surveillance of legitimate, nonviolent groups which merely wish to exercise rights conferred by our Constitution. We urge legislation to include a complete ban on "service monitoring" by telephone companies and other businesses, in the absence of prior notice and consent of the parties. This position, admittedly hardline, was adopted by our 1976 Convention. If telephone monitoring is to be done, it should not be unknown and unobserved by the employees and customers involved. Ten years ago, the California Public Utilities Commission adopted such a position. When this Subcommittee reports legislation, we ask more comprehensive privacy protection provisions.

S. 611 and S. 622 each call for network access charges to be levied to continue the support of local exchange services, at what we hope will continue to be rates affordable to the majority of citizens. The recent ENFIA agreement represents to us an equitable means of settling the long-simmering dispute among communications carriers; we hope the access charge provisions you will be reporting will continue this forward cooperative movement among competing intercity carriers.

We can support the inevitable deregulation of terminal equipment, common to the three pending communications bills, provided there are no hobbles placed on the competitors. We are encouraged that Western Electric and other equipment makers would be allowed to expand their markets without undue fear to litigation. From the standpoint of our members and the members of other Unions employed by Western Electric, we see a positive good and expanding American employment. We believe the 1956 consent decree is obsolete, an impediment to open trade. We understand that numerous telephone cooperatives, telephone companies and other carriers have been interested in buying Western equipment.

Since carrier interconnection would be mandated by both bills, we support an open process in which one party will not dispose of or otherwise direct the use of another's property. We hope any joint planning and management of network operations will not lead to diffusion of responsibility to the user.

On international matters, we prefer to leave Comsat as originally designed to be a carrier's carrier. In dealing with the foreign correspondent carriers, most of which are agencies of the foreign governments, we would prefer to see the United States interest coordinated through an agency such as the National Telecommunications and Information Administration.

ANNEX A

STUDY FINDS TRADE IMBALANCE IN TELCOM

Telecommunications industry critics, particularly the unions, got new ammunition from a recently released study from the U.S. International Trade Commission. Entitled "A Baseline Study of the Telephone Terminal and Switching Equipment Industry," it attempts to assess the balance of trade between the U.S. and other countries and discusses certain other economic realities of the industry.

Among the findings of the 136-page report are: (1) Europe and Japan restrict market access to our equipment manufacturers. The current balance of trade is negative, with a deficit of about \$60 million in 1977. (2) Imports are increasing. The ratio of imports of telephone equipment to consumption in 1972, 1976, and 1977 are said to be 14.5 percent, 15.7 percent, and 17.1 percent respectively. (3) Overall U.S. employment in terminal and switching equipment manufacturing was down by 5 percent in 1977 compared with 1972. (Editor's note: this probably reflects the massive recession-induced layoffs by Western Electric in 1975-76.)

The report stresses interconnect's dependence on imports, noting a "concentration of imports in the non-captive market." It goes on, "Foreign-owned firms enjoy a large market share in branch exchanges because of high demand and FCC actions increasing competition in this market."

"Transactions between unrelated companies approximate the size of the interconnect industry. Foreign-owned firms in the U.S. claimed a 24 percent share of the market in 1977."

NATA: IMPORTS' SHARE HAS PEAKED

The North American Telephone Association understandably opposes some of the content and conclusions of the ITC report. In September, 1978, partly in response to ITC hearings, NATA offered its own report, prepared by J. W. Wilson & Associates. The Wilson study argues that "the share of the U.S. market served by PBX imports has peaked and will diminish over time. . . . The U.S. PBX trade balance will improve in coming years. . . . With today's greatly enlarged domestic PBX production capability and the availability of technologically advanced telecommunications systems from both independent vendors and operating companies, the market advantages previously enjoyed by foreign producers are greatly diminished."

NATA hopes to head off congressional enactment of some kind of protectionist measures, most likely tariffs, which would substantially increase the cost of imports. This would, of course, damage the competitive position of interconnect companies that rely heavily on imported equipment. While the number and output of U.S. manufacturers (phones, PBX's and key systems) are increasing, the significant threat would be sudden price shifts in the short term.

[The following information was subsequently received for the record:]

COMMUNICATIONS WORKERS OF AMERICA,
Washington, D.C., May 16, 1979.

Hon. ERNEST F. HOLLINGS,
Chairman, Subcommittee on Communications, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: On May 3, Secretary-Treasurer Louis B. Knecht provided to your Subcommittee staff copies of a paper on employee protection provisions which we see as necessary additions to S. 611 and S. 622.

For purposes of an official transmittal, I am providing herewith another copy to you.

We wish to work with you and the Subcommittee staff personnel on the most effective method of including the employee protection measures, at the appropriate time. Please let me know if you need other information on the subject.

We have studied Amendment No. 186 to S. 622, to be offered by Senator John G. Tower, and strongly urge its inclusion in any legislation you will be reporting. We find these provisions will become more and more necessary to the safeguarding of the individual's right to privacy as the telephone companies move into "local measured service" and "usage-sensitive pricing" rate structures. Absent a very serious and proven clear need, no agency of government should be able to secure records detailing the use of a given telephone. We do not believe private entities should be able to secure such records at all.

Sincerely yours,

GLENN E. WATTS, *President.*

Enclosure.

S. 611 PROPOSED EMPLOYEE PROTECTION PROGRAM

It has been the uniform and continuing practice of the Congress of the United States to include appropriate provisions for the protection of employees in any legislation which authorizes or requires major changes in pre-existing national policy with respect to public utility or common carrier activities. This long-standing practice rests on both equitable and pragmatic considerations. The Congress has apparently felt that whenever the public interest required substantial changes in legislation governing public utility or common carrier activities, it was only fair and just that the personnel involved in providing these vital services to the public should be given adequate and reasonable protection. In other words, it was felt that such employees should not be the unwitting victims of changes in the structure of the organizations in which they were employed, the technology involved, the services to be provided, or the levels of employment to be maintained. Furthermore, it was recognized that it was in the general public interest to maintain a competent, interested and efficient staff of employees.

Such goals could be achieved only if the persons who might be induced to seek employment were to feel that they would be given adequate protection should the Congress in the future determine that the public interest required any of the above changes. Failure to give such assurance could affect the ability of the industry to attract and retain competent help in the competitive labor market. This in turn would be reflected in the quality, cost, and efficiency of the services provided. It was for these reasons, therefore, that the Congress has invariably included adequate and reasonable employee protection provisions whenever it enacted legislation involving major changes in a regulated industry, particularly if such changes might adversely affect the employees in the industry.

This policy is exemplified, in the case of telecommunications, in Section 222(f) of the Communications Act of 1934, adopted in 1943. Section 222(f) is an integral part of Section 222, which authorized consolidations and mergers of telegraph carriers. The specific purpose of this legislation was to authorize Western Union to acquire the ailing Postal Telegraph company and eventually become the monopoly telegraph carrier in the continental United States. It was recognized that as a result of this legislation, there would be the need to consolidate and possibly eliminate positions in the merged carrier. There was concern even though this legislation was adopted in the midst of World War II, when there was a tight labor market, that employees of both firms being consolidated could be adversely affected. Accordingly, the same legislation which authorized the merger and set forth the terms and conditions under which it could be consummated, contained detailed and elaborate provisions for the protection of the rights of the employees of the organizations which would be merged and consolidated.

More recently, when the Congress considered legislation to rationalize and modernize regulation of the railroads, in the Railroad Revitalization and Regulatory Reform Act of 1976, it included specific provisions for employee protection. For

example, Section 516 of that Act provides that "Fair and equitable arrangements shall be provided, in accordance with this section, to protect the interests of any employees not otherwise protected under Title V of the Regional Rail Reorganization Act of 1973 (45 U.S.C. 771 et seq.) who may be affected by actions taken pursuant to authorizations or approval obtained under this Title." In addition to general provisions for employee protection, specific provisions with respect to employment offers, collective bargaining agreements, termination allowances, payment of benefits, and similar employee safeguard provisions are included in the Act.

The concern of Congress with respect to the protection of employees who might be affected by basic changes in the regulatory control exercised with respect to regulated industries is not limited to situations where consolidations and mergers are authorized or where governmental action is taken because of financial stringency or the threat of bankruptcy. The Congress has been equally concerned about the effects of legislation it is enacting upon employees of the affected industries where the basic nature of Federal regulatory control is altered. It will be recalled that last year the Congress enacted Public Law 95-504, the Airline Deregulation Act of 1978. This legislation was designed primarily to decrease, and eventually, virtually eliminate Federal regulatory supervision over the common carrier activities of airlines. It was recognized that such action, even though it was to be implemented over a period of years, could have serious adverse effects upon employees resulting from structural changes, economic changes, and competitive pressures. Accordingly, the Congress included, as an integral part of the Airline Deregulation Act, Section 43 entitled "Employee Protection Program." The basic purpose of this program was to entitle protection employees to monthly assistance payments if such employee has been deprived of employment or adversely affected with respect to his compensation. In addition, there were provisions for assistance for relocation, if an employee had to move to obtain other employment, and requirements imposed on air carriers to rehire, on a priority basis, employees who were furloughed or otherwise terminated for reasons other than cause.

S. 611, 96TH CONGRESS, FIRST SESSION, INTRODUCED MARCH 12, 1979

S. 611 is essentially designed to enhance competition in the provision of telecommunication services and facilities as well as introduce a large measure of deregulation. In addition, it relies heavily on corporate reorganization and restructuring to achieve its ends and goals and to prevent unfair, competitive practices or cross-subsidization, particularly between any carriers, competitive and non-competitive services, by requiring many activities now provided by regulated carriers to be spun off and provided by fully separated entities.

S. 611 declares it to be the policy of the United States that telecommunication and information services and equipment are to be provided under conditions of full and fair competition, to the maximum extent feasible and consistent with the purposes of the new Bill. It is further provided in the new Section 203 that the sale, lease and other provisions of telecommunication equipment, information software or information services shall not be deemed to be a telecommunication service within the meaning of the Bill. In general, supervision over these activities is limited to the assurance of full and fair interconnection. In addition, the entities which may provide such services are identified, and in general, maximum separation between them and entities providing non-competitive telecommunication services is either required or authorized. Specifically, the Act provides (in Section 203(b)(1)), that no carrier classified as a Category II carrier under Section 204 may offer telecommunications equipment as an integral part of a telecommunication service except as the Commission may allow under such conditions as it may prescribe under Section 205 which sets forth accounting provisions.

The Commission is also authorized to prescribe conditions relating to the separation of Category II carriers' non-competitive telecommunications services from those which are subject to effective competition. Furthermore, the Commission is authorized to require the discontinuance of the provision of any telecommunication service by a Category II carrier which would be inconsistent with the purposes of the bill and is empowered to order such a carrier not to provide such service, or to discontinue providing such service, as the case may be, in accordance with other provisions of the Act.

Insofar as the provision of exchange and inter-exchange services are concerned, there are numerous provisions again requiring maximum separation. Thus, the Bill states that no carrier which provides any exchange service which is not subject to effective competition may also provide any inter-exchange service, other than exchange network access service or participate with an affiliated carrier in the provision of ending inter-exchange service, except by means of the fully separated carrier. Conversely, no Category II carrier which provides inter-exchange public message

telephone service for which it is not subject to effective competition may also provide any other inter-exchange service, except through nondiscriminatory terms to fully separated affiliated carriers or non-affiliated carriers, for the use of such other carriers in providing other inter-exchange services. Furthermore, no carrier which provides any inter-exchange service other than inter-exchange access service shall also provide any exchange service, either alone, or in cooperation with any other carriers, except by means of a fully separated carrier. Category II carriers also may not lease telephone equipment, electronics equipment, information software or information services except through fully separated entities.

The Commission is also authorized to require separate entities for the telecommunications services provided by Category II carriers which are subject to competition and which are not subject to competition.

The consent decree affecting AT&T is also modified to provide that any telecommunication service or equipment which are provided by AT&T are to be deemed regulated common carrier activities. This permits AT&T to enter the telecommunications service and equipment business subject to regulation by the Federal Communications Commission. This amendment, of course, opens this market up AT&T, with presently unforeseeable effects upon market structure as well as upon individual companies supplying the existing and future markets. Since this change results from Congressionally enacted legislation, considerations of equity as well as logic dictate that the employees of industries subjected to sudden and unforeseeable competitive pressures through legislative mandate should be extended the protections equivalent to those extended to employees of regulated entities affected by the legislative action.

Finally, insofar as domestic communications are concerned, Section 221 is broadened to encompass all carriers and the Commission is authorized to grant exemption from anti-trust provisions if the appropriate findings can be made after hearings held pursuant to that provision to any carrier subject to the Communications Act.

In the international field, there is also a major restructuring of the industry. The responsibility for the planning, constructing and operating of international telecommunication facilities is now entrusted to an entirely newly created organization called The International Facilities Management Corporation. However, these facilities are to be owned by a newly created consortium of all international telecommunication carriers which have established requisite operating agreements with foreign correspondents. In addition, 90 days after the enactment of the bill, every telecommunication carrier currently providing or seeking to provide both domestic and international telecommunication services is required to establish a fully separated entity for the provision of either its domestic or international telecommunication services. This entity is also to be subject to whatever terms and conditions the Commission may prescribe. Finally, no international telecommunications carrier which provides international public message telephone service for which it is not subject to effective competition may also provide any other international telecommunication service. This, in essence, would prohibit AT&T's separated international telecommunications entity from providing anything other than international message telephone service.

Appropriate employee protection provisions

The above described changes proposed in the pending legislation will radically alter the nature of regulation of telecommunications within the United States and the general framework within which existing or new carriers will operate. Accordingly, it is not unreasonable to expect that major changes will take place in the structure of the industry and the entities providing service. With the removal of licensing requirements for entry into service by Class I carriers as well as authorizations to diminish or discontinue service, it is to be expected that there will be new entrants into the service as well as discontinuance of service or at least certain types of service by existing carriers, either because of economic stress or policy decisions by corporate management. In addition, by easing the barriers of the consent decree, the bill would probably open a whole new field to competition by AT&T with possible adverse effect on others.

Under the above described circumstances, it is essential, both for reasons of equity and fairness to present employees, as well as to insure stability and continuity in the industry, that the Congress enact appropriate employee protection provisions.

In addition to possible job losses because of the effects of deregulation on particular companies, there is also a high probability that deregulation would be accompanied by consolidations and mergers, both horizontal and vertical, as companies strive to rationalize their respective structures to compete more effectively and to take advantage of the removal of existing barriers to consolidations set forth in Section 222 of the Communications Act of 1934 as amended. In addition, with the stress placed on full separation in the various areas of communication and related

activity, there would be a major restructuring of the corporate entities providing service directly to the public. Class II carriers may also find it necessary or convenient to create fully separated subsidiaries to perform non-regulated telecommunications activities or regulated activities which are incidental to telecommunications. They will also be required to form such separate subsidiaries if they provide both domestic and international communications service, or both intra-exchange services and inter-change services. Finally, there will be a major restructuring of the whole international telecommunications regulatory and operating scheme. A new entity will plan, construct and operate such facilities. Comsat will be able to provide direct service via a fully separated subsidiary. All domestic carriers will be entitled to handle international traffic and will be entitled to inbound traffic in proportion to outbound traffic they give to international carriers, all pursuant to a Commission-prescribed formula.

Each of the above-described actions could, and in all probability would, affect employees of the regulated and unregulated companies involved. Since these changes are authorized by or will take place because of changes in the basic legislation, considerations of equity as well as long-standing precedents indicate that appropriate provisions should be included in the legislation to protect employees in each of these instances.

Thus, there are, in essence, two types of problems to be addressed in the proposed employee protection legislation provisions. The first relates to protection for employees whose job security is adversely affected by the newly authorized competition. The second is affected by corporate reorganizations or mergers, required or authorized by the legislation, or by the creation of separate entities undertaken to operate more efficiently in the new environment created by the pending legislation.

Specifically, it is recommended that a new part, Part Three, be added to Title II, Domestic and International Telecommunication. This should be entitled Part Three—Employee Protection Provisions. Present Part III, Rural Telecommunications Development should be renumbered Part Four. In the new part, there should be a number of sections addressing each of the problems raised and giving employees adequate protection with respect to such problems and potential dangers to job maintenance or job security. We are not in this proposal incorporating the specific language; instead, we are setting forth general ideas. We will, of course, be very happy to work with your subcommittee in drafting the appropriate language for inclusion at this point. Under Part Three, we would suggest that the sections be numbered beginning with 260.

Section 260 could be entitled Definitions. Within Definitions, there should be an appropriate definition of:

(a) a concerned or protected employee as one who has been employed for ten years at the time that this provision becomes effective as an employee of a common carrier licensed by the Federal Communications Commission or as an employee of a company providing unregulated activities which are incidental to telecommunications. The Commission should be required, within a certain number of days after the enactment of this section, to identify those companies, either by name or by service, which are engaged in unregulated activities incidental to telecommunications;

(b) the event or employment loss which qualifies the employee. This might be defined as including bankruptcy or a major lay-off;

(c) a major lay-off. This could be defined as reduction of at least 7.5 percent of the total number of full-time employees of a licensed common carrier or an unregulated common carrier engaged in activities which are incidental to telecommunications;

(d) a collective bargaining agreement should be defined in terms relevant to the industry;

(e) benefits of employees, which could include vacation, sick leave, etc.;

(f) retirement rights and similar privileges which employees have;

(g) merger or consolidation; and

(h) a separate or fully separated entity to carry on functions theretofore carried on by the regulated common carrier or newly created as such to carry on, either regulated or unregulated functions incidental to telecommunications for the first time.

Section 261, Compensation Assurance, should relate to the payments which should be given to employees who lose their employment because of bankruptcy, contractions resulting from the competition authorized by S. 611. This should provide for monthly payments to be given to the employee for the entire period during which such employee is eligible to apply for such monthly assistance. The precedent provided in the Airline Deregulation Act might be applied here to set the period at ten years. This also parallels the ten years of residual FCC regulation. The responsi-

bility could be given to the Secretary of Labor, in consultation with the Chairman of the new Commission for making the appropriate determinations and payments.

Section 262—Comparable Employment: There should also be a provision to resolve disputes as to whether or not employees have been offered reasonably comparable employment and have refused to accept same.

Section 263—Relocation: There should be another provision which would provide for adequate assistance for relocation, if an eligible and protected employee relocates in order to obtain other employment.

Section 264—Term of Payments: The monthly assistance payments should run for a reasonable number of years, ranging from six to ten. In this connection, it is to be noted that the Airline Deregulation Act provides for monthly assistance payments for a period of 72 months or six years.

There should be another series of sections covering the rights of employees affected by mergers, consolidation or the establishment of new and separate subsidiaries to carry on communications activities or activities related to telecommunications as follows:

Section 265—Collective Bargaining Agreements: There should be specific provisions for the continuance of collective bargaining agreements protecting employees in case of a merger or consolidation. In such instances where employees are protected by two separate agreements, the better of the two should be applied to both. In those instances where there is a consolidation or merger and one of the two groups of employees are protected by collective bargaining agreements, there should be adequate provisions to protect those employees who are subject to the consolidation or merger and do not have a collective bargaining agreement. In those instances where there are collective bargaining agreements between employees and two separate organizations or unions, there should be appropriate provisions for the resolution of the difficulty in connection with the consolidation or merger including the administration separately of the separate collective bargaining agreements for their terms and durations with an appropriate means of resolving the differences thereafter.

Section 266—Employee Pensions: There should be a section providing for the protection of employee pension benefits. This should include, in the cases of the establishment of a separate entity an allocation from the pension fund to the new entity which would be held to be statistically adequate to cover the accrued liability with respect to employees to the point of the transfer. In those instances where there is a consolidation or merger, there should be a provision to determine that the existing pension funds are in fact soundly funded and adequate or a provision for an adequate appropriation, either at once or over a period of years to make such funds adequate for the protection of the employees.

Section 267—Other Employee Protection: There should be provisions for maintenance of vacation, sick leave, merit and seniority increases and similar employee benefits which are reflected in company practices but not in any collective bargaining agreement.

Senator HOLLINGS. What exactly is your position relative to the right of privacy on Senator Goldwater's question?

Mr. KNECHT. Our position is that I believe it is—in S. 622, which addressed itself in detail to privacy with CATV operations, we are suggesting that matter be broadened to include other than CATV, and our ideas with respect to that are well contained in the April 2 message of the President to the Congress in connection with the report of the National Commission for the review of Federal and State laws related to wiretapping, electronic surveillance. Such things as access to toll records need to be looked at as to who has access and under what conditions it can be obtained.

Those ideas are included in those documents.

Senator HOLLINGS. Well, I can see we are off to a glowing start. The union is against the bill.

NARUC says study it by a commission.

Professor Oettinger, who got us started in this direction, reminds me of what they used to say aboard ship: "When in danger, when in doubt, run in circles, scream and shout."

I don't know where we are going. Can you tell me?

I yield to you.

The CHAIRMAN. Mr. Firestone, you say S. 611 should be amended to include the phrase "to promote First Amendment values."

Why do you believe that S. 611 is contrary to the first amendment?

Mr. FIRESTONE. I don't believe so. What I would like to see is a positive promotion of the first amendment and first amendment values.

What I would like to see is something more than just concentrating on the economic marketplace, that we look at the marketplace of ideas and make that an affirmative goal of the act.

By the way, in my printed remarks, it says the protection of personal privacy is another goal which perhaps should be specifically included in the goals of the act, as well as the point of equality of opportunity.

The CHAIRMAN. You say that data and information transmissions are peculiar to the commercial and industrial spheres, Mr. Larkin.

Isn't it a fact that cable TV, telemedicine, electronic fund transfers, electronic mail, or similar services are of interest to the individual person?

Mr. LARKIN. I think all the services are of interest, Senator. My point was that these various entities are in a position to take care of themselves.

They can represent themselves and are knowledgeable. The ordinary telephone subscriber, the man in the street, is not.

Our constant concern is whether or not we are giving a great deal more attention to a small sector of the communications world at the expense of that large sector called the man in the street.

Just, for instance, let me illustrate this with connection charges. Only a few years ago they were \$5. Today they are \$45.50, and I predict within the foreseeable future they will be up around \$100.

This is a big item for a little man to pay, particularly if he remembers the happy days of \$5.

The CHAIRMAN. Who do you propose should pay for those connection costs?

Mr. LARKIN. Who? I suggest that we had a very good system when so-called cross-subsidies, took care of the problem.

In the light of a widely held political philosophy, the costs were applied where they could best be applied, rather than on the back of the individual. Business paid more, no question, but they deducted it.

The individual pays a little less and is connected to the network. Business benefits because it can contact the individual.

We had telephone systems where, frankly, without the so-called cross-subsidies, we wouldn't have had one.

The CHAIRMAN. No question about that.

But I am surprised at your statement where you say that the present communications system is now working perfectly.

I think there are a lot of imperfections about it.

There are a lot of ways it could be improved. That is what we are trying to do.

We think by getting competition, more competition, we may improve the system.

Mr. LARKIN. Competition has an end. It may not be the way to go, even though I applaud it. I am a competitor, a very fierce one, and have been all my life.

The CHAIRMAN. Would you prefer monopoly to competition?

Mr. LARKIN. I suggest your present setup is the result of monopoly, and it's not a bad system. Now I believe that there may be areas where competition will work very well, and it can be injected, but I respectfully suggest that competitors are not the least bit interested in social or political goals.

They are only interested in profit. The whole orientation of our telephone system up to now has been service, as opposed to profits.

Actually in my opinion, there is very little profit in the system, if you want to look at it from the standpoint of percentages.

The CHAIRMAN. I must say I was a little surprised to see that A.T. & T. had a profit of about \$5.1 billion. I would not say that is an eleemosynary institution.

Mr. LARKIN. I would want to know what they had to invest to get that profit, Senator.

They could have that kind of money in return and still go broke.

The CHAIRMAN. They got a good bit of that investment money from the ratepayers, no question about that.

Mr. LARKIN. Most of it was probably from them. As a matter of fact, all of it was from them.

The CHAIRMAN. They might have gone out on the open market and gotten some.

Mr. LARKIN. The ratepayers still pay for that, Senator. There is no other way a utility can get money, except from the ratepayers. This is the whole point. Every dime that a utility gets comes from the ratepayer.

A.T. & T.'s investment represents about a 10 percent return on equity which is probably far lower than any other manufacturing or service entity in these United States.

The CHAIRMAN. Does your organization support a monopoly structure in this utility end of the business?

Mr. LARKIN. Our organization is concerned with service, however we get it. Regulated monopoly has worked very well for this country. Working with a monopoly, we as regulators have produced what we believe is a great telecommunications system. We are concerned, Senator, that in changing it, it may not maintain its present salubrious situation. We are not opposed to change. As a matter of fact, we recognize change is necessary.

We have urged changes. But the changes must be studied and they should serve all the people. That is our concern.

Monopoly is not a frightening word to me personally. If a controlled monopoly will do for our society things that competition can't do, I don't think we should let the word frighten us.

The CHAIRMAN. I will tell you, it kind of frightens me a little when you have a monopolistic-type structure and you find that A.T. & T. has a number of rates that are in effect now that have been declared illegal and they are continuing to charge them.

Now at least they have not been held legal. This process has gone on for a long time. It seems to me if those rates have not been legalized through our regular structure, then there has got to be

some slack in the system someplace. Maybe with a little competition we will find out where that slack is and who can take it up.

Mr. LARKIN. I don't know of any rates that have been declared illegal that are still being——

The CHAIRMAN. We had a lot of testimony here on that.

Mr. LARKIN. Then I would suggest the regulatory process was deficient.

If a rate is illegal, whoever declared it then apparently ought to have some obligation to enforce the law.

The CHAIRMAN. I am glad we agree on one thing.

Mr. LARKIN. I see no reluctance on the part of the Department of Justice to take up cudgels against A.T. & T.

The CHAIRMAN. Mr. Knecht, you mentioned the capability of other corporations for cross-subsidization. You listed a number of the corporations in Fortune 500, but those corporations don't have monopoly ratepayers who are captive customers, as a source for cross-subsidy, do they?

Mr. KNECHT. I am not sure, certainly not to the extent, I think, as a layman, that a regulated monopoly like the present telephone system has, no. But I would be surprised if there wasn't a method of helping each other out.

The CHAIRMAN. I saw one in there that might have some cross-subsidy. For example, Southern Pacific.

But there are a lot of those others, I am not sure. They usually don't have captive customers as a source for cross-subsidy.

Mr. KNECHT. I can't argue that question at the moment, sir.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator HOLLINGS. Mr. Knecht, on the protection for employees to protect their pension fund, if put in a separate subsidiary, I would like in detail the exact provisions of protection you would suggest.

Mr. KNECHT. Yes, Mr. Chairman.

Senator HOLLINGS. We would like to get those and see whether they are reasonable in that regard.

Obviously, we can't write it into law, everything we would like.

Mr. Larkin——

Mr. KNECHT. Excuse me, I wanted to say that we filed a paper on the employee protection program this morning with your staff.

You probably just haven't had a chance to see it yet.

Senator HOLLINGS. Thank you. Very good.

Mr. KNECHT. One other thing. In my haste to give a brief statement, I may have left the impression—obviously, left the impression we were totally opposed to these bills. We are in favor of an update of the 1934 Communications Act. There are provisions of the bill we are not opposed to.

Senator HOLLINGS. Thank you.

Mr. Larkin, that is the impression I have from you, that NARUC is opposed to these bills; is that right?

Mr. LARKIN. Let me say we are not opposed to the bills per se. We are opposed to a lot of the provisions which we feel may or may not be workable. Indeed, we applaud your effort to try to rewrite the Communications Act. We recognize the need for Congress to interpose itself into the controversy, which, frankly, was not being resolved by the people, but rather by bureaucrats.

We applaud your entry into it.

All we suggest is that the implementation of your policy, the implementation of your objectives, might be enhanced and better implemented with a higher degree of study and some expertise in the way of inputs to your proposals.

Senator HOLLINGS. Of course, with regard to the study, I think the best of studies is the actual hearings and bringing in witnesses and the expertise you contribute to hearings.

The other witnesses—I remember NARUC coming 3 years ago, where they were legislating a monopoly. Now after 3 years and a couple of years over on the House side, and we had hearings preparatory to starting in this year—last year we had those—after about 3 years, instead of coming in with a solution as NARUC did then on the bail bill—they weren't in doubt.

We wanted to legislate that monopoly years ago.

Now they say, by the way, they are concerned about my being behind and having to listen to these hearings and everything else and why not get a Federal commission to study it? That's what gives me the impression—

The CHAIRMAN. When you say accounting is 90 percent of the situation, do you think the accounting systems are sufficient of A.T. & T. for the State commissions to really make those judgments?

Mr. LARKIN. The State commission has its own accounting system, as the FCC. That is part of the problem in regulation. It's part of the problem in setting rates. There is a chart of accounts which is arbitrary and fixed.

In this matter, we are able to regulate.

The business doesn't give sufficient consideration to the needs for accounting systems to be put in place, so that the regulatory determinations which the business requires can be made.

Senator HOLLINGS. I see.

Mr. LARKIN. In other words, when we make a State revenue requirement on a statewide basis, we have a total requirement. That requirement is then broken down according to categories of service in conformance with what we are able to glean from the accounts of the company.

Senator HOLLINGS. Do you find it fairly uniform, what you are doing in New York and what we are doing in South Carolina, using the same allocation?

Mr. LARKIN. You could probably not use the same approach in every State. Every State has different needs. If you used the same approach in South Carolina as you do in New York, you would be in trouble.

I don't think I have to say to you that New York is a phenomenon. If you try to apply the same rules in South Carolina that you apply in New York, we would have problems for instance with peak rates. In New York City each individual exchange peaks at a different time. For instance, Wall Street peaks, believe it or not, around noon. And maybe someplace else peaks at 10 or 11 at night.

So you have the variables that are almost impossible to bring into any other given system.

You must work on the basis of a knowledge of the community.

For instance, a community of interest is talked about here. I had situations where the community of interest between two points was separated by two counties, because the people had moved but their community of interest had remained constant.

Senator HOLLINGS. Can you explain the reason for the variability referred to by Professor Oettinger, when he talks about within that 25-mile area a 30-cent call for 3 minutes is 30 cents in Montana and 92 cents in Mississippi?

Mr. LARKIN. Very easily.

Senator HOLLINGS. They are both rural States. We don't have the New York problem there.

How do you explain that?

Mr. LARKIN. You have different costs in different States and different investments. You have some telephone entities with 2 percent money from REA. Others are paying 9 and 10 percent. You have different labor rates and different local costs of material.

You have many other variables too. You have underground, as opposed to overhead cable. You have some equipment that may have been there since the year 1. In other areas you have ESS equipment which is far more sensitive.

Senator HOLLINGS. You have a good comparison with Ohio and Michigan. They would be developed, of the same industrial communities, and yet Ohio is 62 cents and Michigan is 25.

Ohio is more than twice that of Michigan.

Mr. LARKIN. That could be easily explained if you went to the numbers. You don't know what their original cost is or what their continuing costs are.

The variables go on and on. That is the difficulty of making comparisons.

For instance, we have a situation upstate where we have one company. It has a different system in the same company. The resolution of that has plagued us for years.

Senator HOLLINGS. I understand that.

When you use the Federal approach, will it be more equalized? Will it be a fairer system? Professor Oettinger, how do you account for the variables?

Mr. OETTINGER. As I indicated in my testimony—we find it difficult to correlate the variability in the costs with the variability in rates.

Mr. Larkin is accurate in pointing out that different States like to put different loads on different folks, to paraphrase another expression.

Senator HOLLINGS. The cost is the same, but it's a difference in allocation?

Mr. OETTINGER. No. There are really wide variabilities in costs. But how the costs vary may have nothing to do with how the rates vary. There is a lot of occult work that folks like Mr. Larkin do—between costs and prices.

If I may for a moment go back to your nautical analogy earlier, mine was not a counsel of despair going around in circles shouting. I simply suggest this, that I think there is an urgency for passing legislation that makes it explicit that encouraging competition is part of the regulatory standard and that the standard is forbearance from regulation so that explaining why regulation, as opposed

to explaining why not regulation. Such standards need to be written into the act to recognize current reality and make it easier for the FCC to forbear regulating without running afoul of the courts.

I might say the absence of such standards, of a competitive standard and a standard of don't regulate unless you have to is a serious hobble to the present commission.

I found that to be the case in my own experience within Massachusetts Cable Television Commission.

We devoutly for 3 years tried to find a lawful formula for decreasing regulatory burdens.

We found no way of doing that without getting hauled into court and very likely losing.

Last year we submitted a bill to the Massachusetts Legislature asking for a simple change in our organic legislation, namely, saying: "Don't regulate unless you have to and explain why you have to regulate." That bill is now on the Governor's desk.

It seems to me that those are two key ingredients needed to permit necessary regulation and avoid unnecessary regulation. My concern is not over what the outcomes are, whether the pie carving is good or bad or who will suffer and who will benefit—it is that specifying too many details in the law is something that may get the Senate and House into an endless swamp, with folks coming back day after day with the kind of hooting and hollering they now do before regulatory commissions. What seems preferable is delegation to regulatory authorities of a more explicit mandate to the effect that it is time to explicitly take the competitive standard into account. It's time explicitly to justify regulation rather than justify the absence of it.

I think that would go a long way.

There is no doubt in my mind that terminal equipment is something that should have been deregulated long ago, although there is also no doubt in my mind that excruciating care needs to be taken in the details of how it's done and that such care cannot and should not be taken in legislation, given continuing rapid change.

Let me give you a case in point.

Where I first came into the terminal equipment issue 10 years ago with some studies of the matter of harm to the network, at that time A.T. & T. was alleging the linemen would fall off poles like flies if anyone else hooked things to their network. They took people to court for selling as foreign attachments gizmos that would go onto the center of the dial, where the number is. They said that would harm the network.

There were absurdities like that, clearly out of place.

Let me jump to the other extreme.

Suppose that in a totally unregulated way somebody sold to every household a gizmo for automatic dialing. You can't get through to the number you want to call, so you press a button and the gizmo keeps dialing over and over again. If one of these were active all the time in every household, nobody could get a call through ever again.

That would put us in a situation of the French telephone system, of which it's said that 50 percent of the folks are always waiting for a phone and the other 50 percent are always waiting for the dial tone.

At that extreme, yes, there can be real harm.

For the Congress of the United States to get itself bogged down into those minuscule shadings, I submit, Mr. Chairman, you haven't got time enough in the world. Tell the FCC they have to justify regulating, not deregulating, but delegate the details to them.

Senator HOLLINGS. I want to thank each of you on the panel for the committee.

We have a rollcall and that is the last call. We have to rush over to make it.

The committee will be in recess until 2 this afternoon.

Thank you.

[Whereupon, at 12:30 p.m., the hearing was recessed, to reconvene at 2 this same day.]

AFTERNOON SESSION

Senator HOLLINGS. Good afternoon. We welcome our panel consisting of Mr. Carr, Mr. Beach, Mr. La Blanc, Mr. Garnett, and Mr. Inglis.

Mr. Carr, would you mind starting for us, please?

STATEMENTS OF ARTHUR CARR, IDCMA; STEPHEN H. BEACH, ADAPSO; ROBERT LA BLANC, CONTINENTAL TELEPHONE CORP.; WILSON B. GARNETT, CENTEL; AND ANDREW F. INGLIS, RCA AMERICAN COMMUNICATIONS

Mr. CARR. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee:

My name is Arthur Carr. I am president of Codex Corp. of Mansfield, Mass., and a member of the board of directors of the Independent Data Communications Manufacturers Association, Inc.—IDCMA. I am appearing here today on behalf of IDCMA and wish to express the association's sincere appreciation for this opportunity to testify.

Mr. Chairman, while I intend to summarize IDCMA's position on S. 611 and S. 622, a paper amplifying points that I will be making is attached to the text of my statement. The association asks that the paper be considered part of its testimony and requests its inclusion in the record of these hearings.

Before turning, however, to the substance of the association's remarks, IDCMA wishes to commend the chairman and the ranking minority member, as well as their respective staffs, for having developed bills which reflect an understanding of basic problems confronting the telecommunications industry today. Resolving the structure of the telecommunications industry will, for better or worse, determine the direction taken by this country in an age when information flow and the availability of telecommunications services are so vital to government, industry, education, health, private citizens and the national economy.

The bills under consideration seek to expand the role of competition in the telecommunications industry. IDCMA, an advocate of free enterprise, supports this goal emphatically. The evolution of the telecommunications industry, already underway, must be allowed to continue, even at an accelerated pace.

In the next few minutes, I would like to do two things: First, I want to share with you what IDCMA feels is a fundamentally important observation about the state of telecommunications in America today, leading to what we feel are proper resolutions to the issues. Then, I will turn to specific remarks related to S. 611 and S. 622.

To begin, in considering the legislative restructuring of the telecommunications industry, we feel that three basic issues should be addressed. First, our current telecommunications system will not support this Nation's needs for information transportation in the 1980's and beyond. Second, the case demonstrating the need for A.T. & T.'s entry into the computer equipment and services industry has not yet been made. Third, the economic power and demonstrated unaccountability of A.T. & T. enables it to set network standards to which other equipment suppliers are forced to adhere. That power permits A.T. & T. to effectively control and thwart competition in the data communications equipment market.

Senator HOLLINGS. Excuse me. We will have to be at ease. Senator Schmitt is coming in a few minutes and we will resume the hearing. I will be back as soon as I vote.

[Recess.]

Senator HOLLINGS. All right, excuse me, Mr. Carr, please continue.

Mr. CARR. Throughout numerous FCC proceedings and congressional testimony, A.T. & T. repeatedly has alleged that: "The United States has the finest telephone system in the world." In what is both a tribute to A.T. & T.'s perseverance and to the old maxim that if you say something often enough, it eventually will be regarded as true, the FCC and Congress appear to have accepted A.T. & T.'s claim. In fact, recent congressional and FCC actions seem to have been based on the assumption that little or no further work is needed in the telecommunications area and that a need exists for A.T. & T.'s digression into the information processing and equipment industry. Those assumptions hinder the process of examining this country's telecommunications needs. Ironically, if accepted, the premise that we already have the finest system in the world may result in policies that would prevent us from allocating the appropriate resources to establish and maintain that very position.

An objective examination of the data transportation handling capabilities of the existing nationwide telephone network demonstrates that our basic system is not the finest available and that the technology gap between basic facilities and the needs of data applications is increasing. IDCMA feels that the following questions must be addressed: Is our total telecommunications system as good as it should be? Will our system be as developed as it must be to support the information explosion of the 1980's and beyond? For example, will existing network facilities be able to support the widespread use of emerging nonvoice network functions such as high-speed facsimile, communicating word-processing, electronic mail and message systems, electronic funds transfer, multinational packet-switching, digital voice, and public information services—to name but a few? As is the case with other vital needs, like energy,

IDCMA believes we must conserve and properly allocate our resources in the field of telecommunications.

When the history of the computer data processing industry is examined, several facts important to the development of future policy become clear. The computer equipment and services industry has a demonstrated record of innovation, accomplishment and service to the public. This record has been compiled without the aid of A.T. & T. Information processing has gone through multiple generations of equipment and software and has repeatedly reduced costs to the using public. Innovations in medical, business, and public information systems have all been brought about by the nonregulated, nonmonopoly information processing industry and by independent providers of communications equipment and services. Such success, achieved in a free market environment, demonstrates the lack of compelling need for A.T. & T. or other monopoly telecommunications common carriers to participate in either the information processing or the data communications equipment and services industries.

In marked contrast to the information processing and data communications equipment industries, the rate of innovation within the information transportation industry has lagged badly. In fact, the most flexible, advanced means of transporting information are provided by nonmonopoly specialized common carriers that have adapted existing telecommunications facilities into specialized networks for more efficient transportation of information. A.T. & T., on the other hand, unfortunately has elected to dissipate its technical, financial, and human resources in multiple vain attempts to play innovation catch up with the information processing and data communications equipment and service industries. A.T. & T. has repeatedly insisted on developing communications products and services that it and the consuming public could otherwise have easily procured from numerous independent suppliers. A.T. & T. has ignored basic facility development to such an extent that corporations like Xerox and IBM, noncarriers, have undertaken to create their own costly telecommunications network offerings.

As explained in detail in IDCMA's prepared statement, much work needs to be done to improve and to develop the United States' basic network. A.T. & T. agrees. Consider remarks made in connection with H.R. 13015 by A.T. & T.'s Mr. Ellinghaus. He stated, and IDCMA agrees, that there is plenty for A.T. & T. to do in the area of telecommunications without A.T. & T. having to branch into other industries.¹

Mr. Ellinghaus's sentiments more recently were echoed by Mr. Charles Brown, A.T. & T.'s new chairman. In an interview printed in the February 20, 1979 edition of Bell Lab News, Mr. Brown responded in the following manner to the question: "Will A.T. & T. move into areas other than communications?" His answer: "No. We feel that our job is large enough and complicated enough, and that the market is big enough, that we don't have any desire or intention of going into some other business. The communications

¹ See Hearings on H.R. 13015, transcript at 11 (July 26, 1978); Ellinghaus prepared statement on H.R. 13015 at 25 (July 26, 1978).

market is exploding. It will undergo tremendous growth in the future.”²

In summary, Mr. Chairman, IDCMA submits that our country's needs can be best served, and the policy issues of the proposed legislation best resolved, by the conservation of our telecommunications resources and the further development of information processing and related equipment and services in the unregulated competitive sector. We believe it would be far better for Congress to provide legislative direction so that A.T. & T. will focus on the necessary research, development, and innovative enhancement of the national telecommunications network, now being seriously neglected. A.T. & T. should be required to concentrate on the things it can do best, that is—providing transparent telecommunications services and facilities for all classes of users, ranging from the home telephone subscriber to multinational corporate users. A.T. & T. should become the American core network utility engaged solely in the provision of communication services. A.T. & T. should be barred from all information processing activities, including those incidental to providing its service. Thus, the consent decree of 1956 should be retained and even strengthened.

I would now like to turn specifically to S. 611 and S. 622. IDCMA submits that if the Congress proceeds with the approach taken in those bills, specific changes would be desirable in order to encourage maximum competition with minimal regulation. While a more complete treatment of these issues is provided in the association's prepared statement, I would like to highlight a few of our major concerns for the subcommittee.

First, for the reasons we have already stated, there should be no legislative attempt to eliminate the consent decree of 1956. Second, the legislation should either require the divestiture in whole or in part of Western Electric and Bell Telephone Laboratories or, at a minimum, should specifically direct the Commission to consider divestiture as a structural remedy that could be imposed to maintain a competitive market. Third, safeguards against anticompetitive conduct must be strengthened and the Commission must be empowered to adopt and to enforce rules during a transition period to insure that the immediate and unrestrained entry of an entity possessed of massive monopoly power does not eliminate competition.

While separate subsidiary requirements, such as proposed by S. 611 and envisioned by S. 622, would be an improvement over the rather disingenuous belief that accounting conventions alone can prevent cross-subsidy, divestiture is a better approach, particularly to problems arising from the vertical integration of Western Electric and Bell Labs within A.T. & T. In fact, as explained in IDCMA's prepared statement, problems involving *de facto* standards, funding of research and development, captive markets, and preferences for Western Electric equipment will continue unless divestiture occurs. If final legislation were to direct A.T. & T. to conserve its resources through the provision of basic communication services, as we have recommended today, divestiture would be much less an issue, since Western would, by design, have no real

² Bell Lab News at 3 (Feb. 20, 1979).

presence in competitive markets and, therefore, no real anticompetitive effect.

Effective competition cannot be expected to arise overnight. Given A.T. & T.'s size, power, and market dominance, there is definite need for a transition period during which the Commission should be empowered to find in the public interest and to oversee the competitive activities of any Bell System entity. For example, during this transition period, the Commission should be able to regulate Bell System Category I carriers in the same fashion as it will regulate Category II carriers. Such oversight should continue until such time as the Commission is satisfied that the workings of the competitive marketplace will no longer be adversely affected by any remaining vestiges of A.T. & T.'s dominance.

In closing, we would like to leave you with this thought: Communications technology is one of our most important natural resources, and also one of our most exportable commodities. It can be a source of economic growth, and most importantly, the means by which we can secure better, more productive lives for our people, for all people. But, like all valuable resources, it must not be squandered or allowed to be manipulated by a powerful few. We must look toward the challenges of the future and depend on the ingenuity of American industry, in a free and competitive environment, to meet these challenges.

Finally, IDCMA soon will submit legislative recommendations for the subcommittee's consideration.

Thank you.

[The statement follows:]

STATEMENT OF ARTHUR CARR, MEMBER OF THE BOARD OF DIRECTORS OF THE
INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION, INC.

I. INTRODUCTION

A. IDCMA

IDCMA is comprised of computers and data communications equipment manufacturers, none of whom are affiliated with telecommunications common carriers.¹ The sophisticated equipment marketed by Association members is used by subscribers in conjunction with telecommunications transmission services provided by AT&T, Bell System operating companies, Western Union, independent telephone companies and specialized common carriers. Association members also market equipment to independent telephone companies. Consequently, the member companies of the Association are directly interested in and are affected by common carrier structure and practices, federal regulations, and any legislative action affecting the sale, or connection of independently manufactured equipment for use with telecommunications services and facilities.

IDCMA companies have been in the vanguard of the development of computer and data communications devices and services which have improved the performance and reliability of data communications systems, thereby enabling significant cost reductions through increased efficiency. Many of the products marketed by these companies have been developed in response to specific market demand for technologically advanced equipment required for the efficient and economical transmission of computer generated data between computers and terminal equipment. Through expenditures for research and development, Association members companies have been able to introduce significant technological innovations and improvements, often years ahead of the telephone industry. Further, Association companies provide highly sophisticated computer communications equipment integral to many

¹ Member companies of IDCMA include: Codex Corp., Mansfield, Mass.; ComData Corp., Skokie, Ill.; General DataComm Industries, Inc., Danbury, Conn.; Intertel, Inc., Burlington, Mass.; Infotron Systems Corp., Cherry Hill, N.J.; Racal-Milgo, Miami, Fla.; Racal-Vadic, Inc., Mountain View, Calif.; Tele-Dynamics, Ft. Washington, Pa.; and Universal Data Systems, Inc., Huntsville, Ala.

business, government, defense and other computer systems not often available from the telephone industry.

As the Subcommittee no doubt is aware, the very existence of many IDCMA member companies, and certainly the success of all, has been enhanced by such competition as now exists in the provision of computer and data communications equipment made possible by the FCC's landmark *Carterfone* decision.² Indeed, competition to the degree it now exists in the domestic telecommunications industry has resulted from FCC action. As the Department of Justice recently observed in comments submitted in the FCC's MTS/WATS market structure inquiry:

"[E]ach time the Commission has relied on competition as a regulatory tool, it has met with substantial success. The Commission's landmark *Carterfone*, *Specialized Carriers*, and *Domestic Satellites* rulings have all had very clear and positive effects from the public's standpoint. Prices for service decreased, the range of options greatly increased, and the rate of innovation proceeded much faster."³

Decisions like *Carterfone*, however, marked just a slight opening of a previously closed door, a door that is still jealously guarded by the telephone industry. In fact, the telephone industry has done everything possible to thwart the possibility of effective competition. The Association of necessity therefore has been very active before the FCC and the courts in seeking to have unreasonably restrictive interconnection regulations removed from telephone company tariffs so that telephone service subscribers could make maximum use of their service. During the course of those proceedings and as a result of the day to day marketplace experience of its members, the Association has developed expertise on market structure issues and on the adverse consequences stemming from Bell System vertical integration. Accordingly, IDCMA welcomes the opportunity to share this information with the Subcommittee in the context of comments on S. 611 and S. 622.

B. Summary of IDCMA position

S. 611 and S. 622 seek to expand the role of competition in the telecommunications industry. IDCMA, an advocate of free enterprise, emphatically supports that goal. The evolution of the telecommunications industry, already under way, must be allowed to continue, even at an accelerated pace. S. 611 and S. 622 correctly recognize that if effective competition is to be truly achieved, fundamental changes are necessary.

To assist the Subcommittee in its deliberations, IDCMA would like to suggest a different perspective in which to view proposed amendments or alternatives to Title II of the Communications Act of 1934. Three basic issues warrant attention. First, our current telecommunications system will not support this nation's needs for information transportation in the 1980's and beyond. Therefore, AT&T should be required to focus its resources on further research, development, and innovative enhancement of America's basic telecommunications network. Second, the case demonstrating the need for AT&T's entry into the computer equipment and services industry has not yet been made. Third, the economic power and demonstrated unaccountability of AT&T enables it to set network standards to which other equipment suppliers are forced to adhere. That power permits AT&T to effectively control and thwart competition in the data communications equipment market.

While IDCMA prefers the more specific approach taken by S. 611, the observations just made apply equally to both bills. There are, however, several major areas where clarification or change is necessary. First, there should be no legislative attempt to eliminate the Consent Decree of 1956. Second, the legislation should either require the divestiture in whole or in part of Western Electric and Bell Telephone Laboratories or, at a minimum, should specifically direct the Commission to consider divestiture as a structural remedy that could be imposed to maintain a competitive market. Remarkably enough, if Bell were to be restricted to the provision of only basic communication services, divestiture would be much less an issue, since Western would, by design, have no real presence in competitive markets and, therefore, no real anti-competitive effect. Third, safeguards against anti-competitive conduct must be strengthened and the Commission must be empowered to adopt and to enforce rules during a transition period to ensure that the immediate and unrestrained entry of an entity possessed of massive monopoly power does not eliminate competition.

² 13 F.C.C.2d 420, *reconsideration denied*, 14 F.C.C.2d 571 (1968).

³ Initial comments of the U.S. Department of Justice in FCC Docket CC 78-72, at 41 (July 12, 1978).

II. A.T. & T. SHOULD BE REQUIRED TO FOCUS ITS RESOURCES ON FURTHER RESEARCH, DEVELOPMENT, AND ENHANCEMENT OF AMERICA'S BASIC CORE NETWORK

Throughout most FCC proceedings, legislative activities, and related testimony, AT&T has repeatedly stated the concept that "the United States has the finest telephone system in the world." The continual drumbeat of that statement has brought a halt to the process of examining our future national telecommunications needs. Ironically, the idea that we have the finest telephone system in the world, if accepted, could even result in national policy that would depart from preserving that very position. As will be shown, our claim to the "finest system in the world" relates only to *voice* communications, local telephone service and message toll service. The United States does not maintain the finest, or the most flexible, *information* communication system in the world.

Because of the misconception that we have the finest telephone system in the world, we have avoided asking ourselves the right questions: Is our basic domestic communications system as good as it should be *today*? And, will our system be as good as it must be *tomorrow* to support the information transportation needs of the 80's and beyond? An objective examination of the non-voice capabilities of our existing network indicates that our system has already been bypassed by others, that it is not the finest available, and that the technology lag is increasing. We must ask: Should we, as a nation, concentrate upon improving our fundamental telecommunications system for both voice and information transportation? Should we ensure that that effort is not diluted by a diversion of financial and human resources? Is there a demonstrated need for participation in the information *processing* industry by organizations, such as AT&T, that must also concentrate upon an acceleration of basic innovation in the area of information *transportation*? And finally, how do we bring about the acceleration of innovation; the availability of capital; and an industrial structure within our system of free enterprise, that will, once again, provide the foundation for a marked and steady improvement in our national information transportation and processing capabilities?

A. *Historical perspective*

More than one hundred years ago, the communications industry began with the development of the telephone. Use of the telephone by both business and residential subscribers resulted in a growing demand for basic telephone services. AT&T, however, monopolized the provision of telephone service which led Congress to enact the Communications Act of 1934 in an attempt to prevent further abuses of monopoly power. Thus, our current monopoly telephone service structure was officially established in 1934 and a system developed commensurate with the communications needs of the American people *at that time*.

In the late 1940's, based on technology developed in World War II, another new industry was forming. The computer evolved from relays and mechanical actuators, to electronic circuitry controlled by vacuum tubes, and by the early 1950's, diverse, large scale, data processing devices emerged. While the development and growth of the data processing industry was clearly accelerated as a result of the invention of the transistor by Bell Telephone Laboratories, the computer industry's overall development was otherwise totally independent of the telephone industry.

By the late 1960's, the computer industry, by then more commonly characterized as the information processing industry, had passed through several generations of computing and peripheral equipment, and had established itself as an integral part of American industry and society. Numerous examples of the beneficial application of computers to industry, health care, business management, and other sectors of our economy, are commonplace. As applications of computer technology expanded, the need to transport information, necessary for and resulting from information processing, became increasingly apparent. Initial applications for military and space programs brought about the first interaction of the information processing and telecommunications industries. By making extremely awkward connections between data processing equipment (designed only for local use) and the basic telephone network (intended only for voice communication) the first rudimentary data communications systems were created.

As the capabilities of the information processing industry increased, the demand for dispersed information processing became increasingly profound. After the 1968 *Carterfone* decision,⁴ there was an almost instant acceleration of the interaction between the information processing and telecommunications industries. The computer industry, operating in a competitive environment, had outstripped more than a half century of telecommunications development in a mere two decades. Telecommunications facilities in the United States were found to be technically inadequate

⁴ 13 F.C.C. 2d 420, *reconsideration denied*, 14 F.C.C. 2d 571 (1968).

for data communications activities, and A.T. & T., for all of its vaunted technology, was unable to keep pace with the implicit demands of data processing. The result was the creation of a third new industry: The data communications equipment and services industry. The new entrant rapidly filled the void created by the disjunctive capabilities of the information processing and information transportation industries. This new industry provided equipment that enabled increasingly advanced information processing equipment to utilize the telephone network. It allowed the expansion of services by virtue of innovative technical developments (like high-speed modems and multiplexers); brought pressure to bear on A.T. & T. to increase its rate of basic facilities innovation; and permitted, for the first time, the routine transfer of information, even across national borders.

B. The present

History provides us with much to develop our future plans. The information processing industry has a demonstrated record of innovation, accomplishment, and service to the public. It has grown, even flourished, without the aid or assistance of A.T. & T. Information processing has gone through multiple generations of equipment and software and has repeatedly reduced the cost of data processing technology. As recently as January of this year, press announcements about IBM's new 4300, E-Series claimed increased computer power per dollar by a factor of five to eight. Medical systems, reservation systems, management information systems, and many others, have all been brought about by the unregulated non-monopoly information processing industry, and the communications equipment and services industry.

In marked contrast to information processing, the rate of innovation in the information transportation industry has lagged badly. In fact, the most flexible, advanced means of transporting information are provided by non-monopoly resale carriers—such as Tymnet and Telenet—that have developed existing telecommunications facilities into specialized applications for more efficient transportation of such information. A.T. & T. has, unfortunately, elected to dissipate its resources in multiple vain attempts to plan innovation “catch-up” with data communications equipment manufacturers, and to mount major, costly, programs to penetrate the information processing industry. Resources expended in lengthy development and introduction cycles for telecommunications devices that could have been purchased from outside suppliers, and for information processing devices, such as the recently introduced Dataspeed 40/4, are counter-productive to the basic interests of the telecommunications system in the United States. Costly projects by previously non-telecommunications organizations like IBM and Xerox, designed to create data distribution networks of their own to fill the technical void left by A.T. & T., a void which might ultimately limit development of their own primary business efforts, are also indicative of a needless waste of resources.

The Federal Communications Commission and the Congress, by assuming that we have the finest telecommunications system in the world and that innovation by A.T. & T. is required for further advances in information processing, have in fact concluded that the problems to be solved really only relate to the definitional difficulties of separating information transportation from information processing. The problems to be solved are not definitional. They do not relate to information processing deficiencies that A.T. & T. could potentially solve, but they relate, instead, to the need to establish *programs and policies*, designed to bring about the recovery of our domestic tele-communications network to levels which can *fully support* our information requirements in the decades to come.

C. The future

In the 1980's and beyond, the domestic telecommunications network will continue to be dominated by voice traffic. However, the transportation of data will grow from less than six percent of total traffic volume to more than a quarter of total usage.⁶ The economic and social impact of data-oriented traffic, already substantial, will be beyond measure. Today, nearly half the Gross National Product (GNP) and three quarters of the work force are associated with information handling, creation, or distribution. The wealth and power of nations is no longer measured in gold or geographic boundaries, but in terms of the ability to create and control *information*. Conversely, a reduction in ability to control the transportation of information must be equated with a potential loss of economic and political power. Hence, a comprehensive basic telecommunications network must be viewed as an essential contribution to America's future well-being.

The manifold increase in information-handling networks is due to the expansion of conventional data communication networks, like those operated for Fortune 1000

⁶ See *Telephony* magazine at 15 (Feb. 26, 1979).

and multinational corporations, as well as the almost explosive growth of new applications. In recent years network-dependent services have begun to emerge that promise real social and economic benefits to the user. Electronic funds transfer (EFTS), worldwide travel reservation systems, public (packet) data network utilities (TRANSPAC, NDN, Tymnet, Telenet, etc.), and public information/entertainment utilities (Viewdata, Antiope, Prestel, etc.) are but a few examples.

Remarkably, until recently, applications of computer technologies have been notably absent from the office environment. Currently, the average per capita investment per office employee is approximately \$2000, as compared with \$25,000 per factory production worker.* With the majority of the work force concentrated in the office environment, the increasing costs of labor and the need for better productivity, control, and accuracy, computer technologies can be expected to play a vital role in the "office of the future." Communicating word-processing and facsimile terminals will eliminate the long and costly manual dictation/typing/revision/duplication/document distribution system used today. Teleconferencing will eliminate some of the need to travel to remote locations, thus saving time and energy resources. Eventually, the conventional centrally located office may be replaced entirely by people working at home, on terminals, all interconnected by a comprehensive worldwide information transportation network.

These new applications and activities, many multi-national in scope, will require substantially different and more sophisticated communications facilities than those in place today. In fact, the narrow-band switched network, used today to support converted analog voice traffic, will be utterly overwhelmed and totally inadequate.

In a recent speech to the Florida Telephone Association, G. Lorenz, President of United Computing Systems, Inc., stated that telephone companies must improve their network's capabilities to meet the challenges of fast-moving computer technologies, as well as competition from satellites, value-added carriers, and others. "Today, the capacity of the computer far outpaces the capabilities of the network to carry data," Lorenz asserted. He also noted that:

"Computer output capacity is measured in millions of characters per second, while the throughput of the networks is measured in thousands of characters per second. I think we'll see a big upsurge in the delivery of information to homes and businesses. There will be more and more demand for access to large data bases, for the delivery of electronic news and advertising to the home, and perhaps most of all, for business-oriented electronic mail that does, in an instant, what it takes the post office a week to do."

He's right.

What is desperately needed is a combination of conventional, switched, analog links, joined to wideband digital facilities, capable of supporting the enormous quantities of two-way traffic. Additionally, local distribution facilities will require replacement or augmentation, using fiber optics, microwave, and satellite technologies. Designing, building, and managing a network of this magnitude represents an undertaking far in excess of anything Bell has ever done before. The technical challenge is enormous. To underestimate it would be tragic.

Given the task at hand, a task that Bell should indeed undertake, must undertake, to serve the future needs of the American people, there hardly seems room for the kind of duplication of effort brought about by companies in the information processing industries creating information transportation facilities because of the lack of acceptable available services; or by Bell attempting to diversify into information processing, and in so doing expending resources for products and services that could more readily be acquired from other manufacturers. This kind of waste is a luxury we can ill afford. As a nation, we must learn, as we are beginning to learn about energy-related resources, to carefully manage and direct the talents and resources we have, in ways that best advance our capabilities in the future.

We must recognize that AT&T is simply not needed within the information processing industry, and we must insist that AT&T concentrate on the things it can do best; i.e., providing basic telecommunications services for all classes of users, ranging from the home telephone subscriber to multinational corporate users. By establishing AT&T as the American basic core network utility, all of its resources can be focused on the recovery, development, and expansion of our telecommunications system. AT&T should be barred from all information processing activities. Its role should be restricted to the provision of an essentially transparent network. Separate subsidiaries, requirements of arms-length dealings, and all the other mechanisms previously suggested to separate competition from regulated activities are, in fact, less effective in preventing cross-subsidization, inappropriate accounting procedures, and a diversion of resources away from the successful implementation of

* Dorn, Philip N., "The Road to Disaster," as published in *Datamation* at 156 (Nov. 15, 1978).

Bell's primary role. The Consent Decree of 1956 should not be discarded but, rather, strengthened and retained. What is required is a fully regulated public utility, effectively prevented from engaging in competitive services, in order to satisfy our nation's future basic telecommunications needs. The country should then turn to, and rely upon, competition and the free market to satisfy its other technical requirements.

III. ALTERNATIVELY, WESTERN ELECTRIC CO. AND BELL TELEPHONE LABORATORIES SHOULD BE DIVESTED

If, as has been suggested in IDCMA, AT&T was restricted to the provision of the basic core network, divestiture would be much less an issue since Western Electric would have no real presence in or anti-competitive effect on competitive markets. In the event, however, that Congress is reluctant to follow the course of action just outlined, Congress, at a minimum, should specifically determine whether the public interest would be served by allowing AT&T to participate in the information processing and data communications equipment and services industries on an unregulated basis. In doing so Congress should not lose sight of the record of AT&T's forays into the competitive sector.⁷ That record raises serious questions whether the public interest will be served by AT&T's participation. If after careful evaluation of all the relevant facts, Congress should decide that the public interest will be served by allowing AT&T into non-communications businesses, IDCMA urges Congress not to categorically rule out divestiture, especially with respect to AT&T's vertically integrated manufacturing and research and development arms.

A. Bell System vertical integration has thwarted competition and technological development—A synopsis

The vertically integrated Bell System dominates the domestic telecommunications industry. This dominance is not necessarily attributable to the Bell System's innovativeness. Rather, it is a product of the virtual monopoly position which the Bell System has enjoyed, as well as its vertical integration. The problems which have resulted from this vertical integration directly relate to the Bell System's attempts to simultaneously supply both monopoly and competitive services and equipment.

The interrelationship of Western Electric Company, American Telephone and Telegraph Company (AT&T), Bell Telephone Laboratories and the remainder of the Bell System has generated these problems. Western Electric, AT&T's wholly owned equipment manufacturing subsidiary, has a dominant position in the manufacture and supply of telecommunications equipment. This position has resulted from a number of factors that have served to thwart the possibility of full and fair competition and that have adversely affected technological development. These factors include:

1. Prices for Western Electric equipment marketed in competition with that of other suppliers do not necessarily reflect all amounts spent for research and development by Bell Telephone Laboratories which receives research and development funds from charges assessed for monopoly telephone services provided by the Bell System. Thus, the development of Western Electric's competitive equipment offerings is subsidized by the monopoly ratepayer and affords Western Electric an unfair competitive advantage because its competitors must recover research and development expenses in the prices of equipment marketed in competition with Western Electric.

2. Western Electric has a captive market in that its supplies, on a sole source basis, the bulk of equipment used by Bell System Operating Companies (BOC's) and AT&T Long Lines. Further, arrangements between Western Electric and the BOC's put the full risk of marketing competitive equipment on the BOC's.

3. Western Electric hold patent rights for competitive equipment and for network operation compatibility, even though development of such technology is funded by monopoly ratepayers. Other manufacturers wishing to provide such equipment must enter licensing arrangements for which fees are paid to Western Electric.

⁷ See, e.g., *AT & T Company*, 67 F.C.C. 2d 1195 (1978), *reconsideration denied*, *Transmittal 12790*, *Memorandum Opinion and Order* (78-879) (Jan. 5, 1979) (rejection of A.T. & T.'s revised Dataphone Digital Service for failure to comply with FCC orders); *DDS Rate Case*, 62 F.C.C. 2d 774, *reconsideration denied*, 64 F.C.C.2d 994 (1977); *review pending sub nom. AT & T v. F.C.C.*, No 77-1742 (D.C. Cir.) (rejection of original Dataphone Digital Service tariff as anti-competitive in effect); *Docket 19919*, 55 F.C.C. 2d 224 (1975) (interim decision that FCC could not rule on legality of A.T. & T. analog private line rates because of lack of information even after extensive hearing); *Hi-Lo*, 58 F.C.C. 2d 362 (1976) (rejection of A.T. & T. analog private line rates as unlawful because of A.T. & T. failure to sustain burden of proof); *Docket 19989*, 59 F.C.C. 2d 671 (1976) (four previous WATS tariff filings declared null and void); *EATS*, 66 F.C.C.2d 9 (1977) (revised WATS filing declared null and void on basis of 19 independent grounds); *Docket 20814* (Phase I) *Initial Decision* (F.C.C. 79D-8) (Mar. 19, 1979) (A.T. & T. MPL tariff rejected).

4. Because of the dominant position of AT&T and the relationship of AT&T, the BOC's and Western Electric, network interface and operation standards are based around Western Electric equipment. This means that the Bell System effectively determines the standards which competitors must use.

5. Finally, because Western Electric provides both monopoly and competitive equipment, there is no effective means under the current structure to prevent it from manipulating equipment prices so as to lower its competitive prices at the expense of the monopoly service user.

In order that the problems occasioned by vertical integration can be better understood, it is necessary to consider both the mechanics and the effects of Western Electric's vertical integration within the Bell System.

B. The mechanics and effects of Western Electric's vertical integration within the Bell System—The mechanics

AT&T, on an annual basis, assesses each Bell Operating Company (BOC) a portion, not to exceed 2.5 percent, of each company's adjusted revenues for what are called License Contract Services fees. A major portion of these assessments goes to Bell Telephone Laboratories (Bell Labs) to be used for funding research and development and other services. The amounts involved are enormous. For example, for the twelve month period ending on April 30, 1976, the staff of the California Public Utilities Commission (CPUC) found that some 40 percent of License Contract Expense or some \$218,007,895 originated at Bell Labs.* Of that amount, "approximately \$153,860,299, or 70.6 percent of BTL's (Bell Labs') Total research and development costs were product related and should have been funded by Western Electric."

Since the overwhelming majority of BOC revenues come from the provision of "monopoly" telephone services such as local exchange, intrastate toll, interstate toll, and WATS, most of these fees are paid for by monopoly telephone service ratepayers. While these funds should be used as an investment to provide better basic telephone service and not to provide AT&T an opportunity to extend into other non-telephone businesses, Bell Labs can and in fact does use these funds to develop equipment for use in non-telephone competitive service offerings. This diversion of funds into non-telephone development can adversely affect the public through higher monthly telephone rates or lack of telephone service improvements or both. Independent manufacturers do not have their research and development efforts subsidized by the monopoly telephone ratepaying public. Thus, Western Electric enjoys a definite competitive advantage through this subsidy for research and development.

Further, Western Electric does not need to recover research and development expenditures from sales revenues received for competitive products developed. Rather, it can charge or debit broad general product line accounts which contain both Monopoly and non-monopoly products. These charges are spread within these product lines on the basis of the dollar value of the products. Since the value of equipment having monopoly characteristics in these accounts far exceeds that of the competitive equipment, the monopoly telephone equipment and the captive monopoly telephone service ratepayer bear the burden of competitive equipment research and development.

Western Electric position within the Bell System also provides it with a captive market in the form of the BOC's. The bulk of all equipment purchased by the BOC's and by AT&T Long Lines is conceived, designed and manufactured by the Bell Labs, AT&T, Western Electric consortium. Western Electric's position is further enhanced by its patent holdings as well as by the fact that AT&T prepares Bell System operating practices based on Western Electric equipment and requires use of that equipment. Because of the arrangements between Western Electric and the BOC's, the full risk of marketing competitive products is borne by the BOC's. The BOC's purchase "sole source" from Western Electric and have virtually no recourse against Western if Western exercises just plain bad judgment by introducing products which are unsuccessful or by making the product cost more or by making it difficult to market. Unlike an independent manufacturer, Western Electric can thus transfer all risks to the BOC's and ultimately to the monopoly telephone ratepayers.

Because of the Bell System's currently dominant position in the domestic telecommunications industry, AT&T and the BOC's "control" the telephone network. This control enables them to set *de facto* standards around Western Electric equipment for network interfacing and for network operation compatibility. Other equipment manufacturers are thus forced to conform to Western Electric equipment standards.

* CPUC Finance Division Report on the Affiliated Relationships of the Pacific Telephone & Telegraph Co. with Bell Telephone Laboratories, Inc., A.T. & T. General Departments 195 Broadway Corp., Application No. 55492, at 1, 2-8, 2-28 (Aug. 26, 1977).

* Id. at 2-28. Further CPUC staff comments on this subject are attached as appendix A.

These *de facto* standards apply even in the competitive non-telephone equipment market which gives the Bell System the ability to affect the design and cost of competitive equipment. Further, other manufacturers may be forced to enter into licensing arrangements with Western Electric to *try* to assure compatibility with Western Electric equipment and network interfaces. The word "try" is emphasized because even when a license arrangement exists, Western Electric takes no responsibility to assure that the licensee is or will be provided with information about subsequent design changes whether necessary to correct equipment deficiencies or to improve performance.

Western Electric also acts as purchasing agent for the BOC's and also evaluates independently manufactured equipment for use by the BOC's.¹⁰ Considering the "preference" which the BOC's have for Western Electric, these activities effectively give Western Electric direct control over sales of independently manufactured equipment to the BOC's. Also these activities allow Western Electric to gain detailed information on the concepts, features, and performance of independent equipment for use in Western Electric's own developmental efforts.

Finally, it must also be recognized that the vertically integrated Bell System has a conflict of interest between maximizing its capital base in and revenues derived from facilities in place, and innovation that would permit better utilization of existing facilities. The Bell System actually has an incentive to build new facilities rather than to more efficiently use existing ones since new facilities can be used to inflate the rate base and hence the revenues to be derived.

C. The effects

What have the effects of this vertical integration been? To begin with, because of the monopoly subsidization of its product costs, Western Electric is in a position to artificially price its so-called competitive products at prices lower than can be offered by competitors. Accordingly, the subsidized underpricing of Western Electric's products has clearly provided an unfair competitive advantage to Western Electric.

The vertical integration of Western Electric within the Bell System has occasioned other serious problems as well. Given the relationship of Western Electric, AT&T, Bell Labs and the BOC's, it is virtually impossible to ascertain the true costs of equipment provided by Western Electric. Rather, costs are hidden and effectively shifted among Bell System components to a point where they cannot be identified and properly attributed to those items which have led to their being incurred. The Association has found this to be the case time and time again in proceedings involving rates for Bell System competitive equipment offerings¹¹ and competitive services.¹²

In fact, this problem was central to the FCC's deliberations in Docket 18128 on proper cost identification and attribution procedures and is central to the FCC's rulemaking on modifications to the Uniform System of Accounts.

AT&T's vertical integration has also served to thwart competition in the provision of data communications equipment to independent telephone companies. Independent telephone companies participate in the provision of interexchange services by concurring in AT&T Tariffs. That concurrence carries with it a commitment to use equipment that is compatible with AT&T equipment standards. Settlements for jointly provided services require equipment compatibility. Accordingly, AT&T's control of the network, settlements, and tariff filings, allows it to set *de facto* standards to which independent telephone companies and independent equipment suppliers must conform. Thus, AT&T controls the technical characteristics of equipment used as well as the availability and timing of service offerings in the *entire* domestic telephone industry and thereby exerts undue influence on the procurement practices of independent telephone companies.

While S. 611 and S. 622 would allow Western Electric to actively pursue the independent telephone company equipment market, no corresponding obligation is placed on AT&T to open the huge captive Bell operating company equipment market to meaningful competition. The net result is a foreclosure of the independent telephone equipment market and a limitation of innovation. This foreclosure would result from AT&T's continued ability to set standards and to control tariff filings. As long as Western is vertically integrated within AT&T, AT&T has both the incentive and the opportunity to set standards in a way to favor Western

¹⁰ This relationship was investigated in FCC docket 19129. As a result, the Bell System has been directed to formulate a proposal for a separate procurement entity to insure that the BOC's deal on an arm's length basis with both the general trade and Western Electric. Bell's proposal, however, was entirely inadequate for reasons detailed in appendix B.

¹¹ See IDCMA Proposed Findings of Fact and Conclusions of Law in FCC docket 19419.

¹² See cases cited in n. 7 *supra*.

products. Since AT&T has complete control over the filing of interstate tariffs, interconnection to services specified therein, and the standards associated with equipment to be used in or with such services, AT&T can selectively manipulate the timing of tariff filings to correspond to when equipment and facilities required in the provision of services are available from Western.

By obtaining tariff concurrences from independent telephone companies and through the work order process, AT&T can effectively market Western Electric equipment to independent telephone companies without any marketing expense. This is especially significant where new services are involved since Western Electric becomes the primary supplier to the independent telephone companies. Independent suppliers, by virtue of not being given timely planning information, are relegated to secondary supplier roles in support of existing services. This dictates conformity, not innovation.

The relationships producing the adverse consequences just described are the product of many years. As has been recognized, effective competition in the telecommunications industry will not happen overnight just because Congress declares it to be a national policy. Similarly, the adverse consequences of vertical integration, especially the preference of Bell System entities for Western Electric equipment, will not be overcome unless very definite steps are taken. The human relationships affected by growing up in the Bell System cannot be underestimated since they produce a day to day buyer's attitude perhaps best reflected in the following quote:

"I would like to think of AT&T as a manufacturing company that happens to have a few operating departments. The captive giant of which they were once part has their loyalty always."¹³

D. Possible solutions

While separate subsidiary requirements, such as proposed by S. 611 and envisioned by S. 622, would be a vast improvement over the rather disingenuous belief that accounting conventions alone can prevent cross-subsidy, divestiture is a better approach particularly to problems arising from the vertical integration of Western Electric Company and Bell Telephone Laboratories within AT&T. In fact, problems involving *de facto* standards, funding of research and development, captive markets, and preferences for Western Electric equipment are likely to continue unless divestiture occurs.

As previously noted, although S. 611 and S. 622 would allow Western Electric to sell to non-Bell companies, no corresponding obligation is imposed upon AT&T or on the Bell operating companies to deal with outside suppliers.¹⁴ This is a serious problem in light of the longstanding preference for Western Electric equipment which Bell System entities, whether part of the basic Bell System monopoly or separate subsidiaries, can be expected to retain. There is nothing in either bill to preclude Bell's competitive subsidiaries from obtaining equipment solely from Western Electric. In IDCMA's view, failure to require Bell monopoly and Bell competitive entities to deal with outside suppliers will adversely affect consumer choice because even if AT&T's competitive and monopoly operations are separated, no real changes will occur in the procurement policies of AT&T affiliates. Accordingly, Western Electric will retain a captive market of affiliated carriers, whether monopoly or competitive.

Further, ample opportunity will still exist for cross-subsidy. Consumers, in turn, would not receive the benefits of greater choice, true cost deficiencies and increased innovation which the competitive supply of such equipment would otherwise occasion.

Major difficulties would remain even if Western Electric and Bell Telephone Laboratories were required to set up separate subsidiaries for the "competitive" aspects of their operations. Although S. 611 and S. 622 seek to provide methods to overcome the anticompetitive results of AT&T's vertical integration, the same basic problems that exist today would remain because S. 611 and S. 622 effectively would allow vertical integration to continue. Thus, AT&T's "competitive" operations could still buy all of their equipment from Western Electric since the engrained habit of buying Western equipment will not be shed lightly. Similarly, trading of information and insights on network design and equipment requirements will continue. Finally, Congress should not lose sight of the reality that AT&T is well entrenched and has accumulated vast power as a result of governmentally granted franchises. Divestiture would solve such problems and thus is a far better means through which to accomplish the purposes of the bills.

¹³ Brooks, John, "Telephone: The First One Hundred Years" at 12.

¹⁴ Both bills thus reflect a deregulation tone. As explained in appendix C, deregulation of monopoly common carrier terminal sales without adequate safeguards and supervision portends disastrous consequences for the competitive terminal equipment market.

The divestiture remedy could take one of several forms. One approach would involve separating Western Electric and Bell Labs from AT&T. These companies, in turn, could be broken into smaller, totally separate, companies in accordance with the provisions of the nation's antitrust laws. Such further subdivision would appear necessary in light of the enormous size and market power which a divested Western Electric would be likely to possess.

Under this first approach, Western Electric would be divested and reorganized into a number of autonomous companies. For example, one logical division would entail provision of non-voice equipment. Each such company would have to meet the separate subsidiary requirements of S. 611 as well as the additional safeguards specified in Section IV of this statement. Accordingly, each separate company would conduct its own manufacturing, marketing, sales and service activities and thus would have to compete on the same basis as any other manufacturer. In addition, each company would have to conduct or obtain its own research and development. With respect to research and development, those sections of the divested Bell Labs which before divestiture gave direct engineering support to a given segment of Western Electric could be spun off and made part of the smaller, equipment-line companies just described.

Another divestiture alternative would entail having the Bell System spin off all of its non-voice equipment manufacturing, research and development and sales activities into a totally separate, autonomous company.

Finally, should Congress decide not to require divestiture, it should at a minimum direct and empower the Commission to consider and to impose divestiture as a structural remedy necessary to maintain the competitive market. While Section 207 of S. 611 seems to give the Commission the authority to impose divestiture, that authority should be specifically clarified.

IV. ADDITIONAL SAFEGUARDS AND A TRANSITION PERIOD ARE NECESSARY

A. Need for additional safeguards

Should it be deemed appropriate for AT&T to have a role in competitive activities—whether communications, data communications equipment or information processing, use of separate arm's length subsidiaries is mandatory. While the separate subsidiary is not the most effective solution for problems arising from monopoly carrier vertical integration, its general efficacy could be enhanced by use of additional safeguards. These safeguards, listed below, should apply to the subsidiaries of Category II carriers and to any Category I carrier that is affiliated with a Category II carrier as well as to holding companies that have a Category II carrier.

1. Reasonable limits should be imposed on the amount and form of any separate subsidiary's capital structure. A parent holding company or affiliated Category II carrier should not hold more than 33 percent of the shares of any other affiliated carrier or separate subsidiary;

2. The services or equipment which separate subsidiaries are to be permitted or required to provide should be specifically identified;

3. Separate subsidiaries should act independently of each other and of the parent holding company in the provision of services, equipment, advertising, sales, marketing, accounting, and customer relations. Research and development as well as the Engineering and operating departments of subsidiaries should be separate and apart from those of the parent holding company and those of other affiliated carriers on subsidiaries;

4. A separate subsidiary should not be permitted to employ as part of its own sales, marketing, promotional or manufacturing activities, the parent holding company's name or any words or symbols either contained in or associated with either the parent holding company's name or that of any other carrier affiliate;

5. Separate subsidiaries should not be permitted to obtain advertising, sales, marketing, accounting, customer relations, research and development, engineering, and operating assistance from other affiliated subsidiaries or from the parent holding company or any of its Category I or Category II carriers;

6. No joint advertising, sales, promotional, marketing, or operating efforts should be permitted between separate subsidiaries or between separate subsidiaries, the parent holding company, or affiliated carriers;

7. Carrier affiliates should be prohibited from providing information to either their own equipment subsidiaries, or to other affiliated equipment subsidiaries, relating to the identity of customers, customer locations, nature of the customer's service, requests for additional service from customers, or any other information relating to customers or competitors; and

8. To the extent that carrier affiliates secure equipment or other services from the parent holding company or from other affiliated subsidiaries of the parent, such equipment or services must be secured on an arm's length basis. No affiliated

carrier or equipment production or sales subsidiary should be allowed to obtain equipment exclusively from other affiliates of the parent holding company. Rather, affiliated carriers and equipment subsidiaries should be required to deal on the open market with other suppliers for procurement of their equipment needs.

9. The Commission should be empowered to require standard accounting and to impose rules governing transactions between the parent holding company, any affiliated Category II and Category I carriers, and any separate subsidiaries. In addition, the Commission should be empowered to supervise the purchasing policies of the parent holding company, any affiliated Category II and Category I carriers and separate subsidiaries.

Additional safeguards such as these are necessary if effective competition is to be achieved.

B. Need for transition period

As the Senate has recognized, effective competition cannot be expected to arise overnight. Given AT&T's size, power and market dominance, there is definite need for a transition period during which the Commission should be empowered to oversee the competitive activities of any Bell System entity. For example, during this transition period, the Commission should be able to regulate any Bell System Category I carrier in the same fashion as it will regulate Category II carriers. Such oversight should continue until such time as the Commission is satisfied that the workings of the competitive marketplace will no longer be adversely affected by any remaining vestiges of AT&T's dominance.

V. CONCLUSION

Communications technology is one of our most important national resources, and also one of our most exportable commodities. It can be a source of economic growth, and most importantly, the means by which we can secure better, more productive lives for our people, for all people. But, like all valuable resources, it must not be squandered or allowed to be manipulated by a powerful few. While we can be proud of our past accomplishments, we must look forward to the challenges of the future and depend on the ingenuity of American industry, in a free and competitive environment, to meet these challenges

APPENDIX A

In addressing the Bell System's method of funding Western Electric's research and development efforts the staff of the California Public Utilities Commission found that:

"The present method of funding research and development (R&D) results in costs which relate to, or result in, scientific knowledge essential to product development being passed on to the ultimate consumer prior to supplying the product itself. The benefits of this funding method accrue directly to Western Electric, in that Western does not have to reflect these costs in its operations and therefore, does not have to recover such costs through the sale of its products. The staff does not know of any other manufacturer that is able to have its customers fund R&D work prior to selling them a product. Other manufacturers must of necessity include any R&D expenses as an element of cost in determining the price at which they can profitably sell their product."¹

The CPUC Staff further concluded:

It is obvious that this funding method gives Western a decided competitive advantage over other manufacturers of telecommunications equipment in that Western does not have to recover certain R&D costs through its product prices. Under such circumstances, price comparisons between Western products and those of other telecommunications manufacturers become meaningless. Since Western's prices are not reflective of the true economic cost of its products, price differentials between its products, and competitors' products could be very misleading.

"The staff finds it difficult to comprehend how Bell operating companies are presently able to make meaningful product price comparisons when Western's prices do not reflect R&D costs and when those operating companies have already paid for those R&D costs in their License Contract expenses. What is the real price of Western's products? If these costs were funded by Western Electric and reflected in the prices of its products sold to the operating companies, those operating companies would be better able to make meaningful price comparisons between

¹ CPUC Finance Division Report on the Affiliated Relationships of the Pacific Telephone and Telegraph Co. with Bell Telephone Laboratories, Inc., A.T. & T. General Departments, 195 Broadway Corp., Application No. 55492, at 2-22.

competing suppliers' products, since R&D costs would be included in the price of all products on the same basis. * * *²

APPENDIX B

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, D.C.

Docket 19129

In the Matter of: Bell Operating Company Procurement of Telecommunications Equipment

COMMENTS OF THE INDEPENDENT DATA COMMUNICATIONS MANUFACTURERS ASSOCIATION, INC. (IDCMA)

Introduction and summary

AT&T's proposed reorganization to establish an Entity for general trade suppliers fails to fulfill the requirements specified in the FCC's decision in Docket 19129. The basic problem with AT&T's proposal is that it does not provide for the equitable treatment of general trade suppliers vis-a-vis Western Electric Company (Western), as required specifically by the FCC order. The establishment of an Entity within AT&T would have meaning only if Western likewise dealt through the Entity for the sales of its products to the Bell System. The Entity should be so established to provide meaningful, timely information regarding forecasted requirements, etc., to all potential suppliers to the Bell System, general trade and Western; this information should be provided to both parties in the same form and at the same time. Furthermore, the Entity should insure participation by both the general trade suppliers and Western in discussions regarding future service plans of the Bell System, so that the capabilities, products, and technological concepts of both can be considered for possible application in future service and product offerings of the Bell System. The Entity should be the point of contact for both general trade suppliers and Western regarding product evaluation and product standardization activities. The Entity should act as the stocking distributor for the Bell Operating Companies and should develop standard supply contracts for use *both* with Western and general trade suppliers. The Entity should also have a repair capability and an inventory stocking capability. While the general trade suppliers and Western should be free to deal directly with the Bell Operating Companies themselves, there must be assurances of equitable treatment for both the general trade suppliers and Western. In addition to purchase of products, the Entity should have the ability to contract with Western and general trade suppliers, on a competitive basis, for the reasearch and development of future product requirements. The only means by which equal treatment can be achieved is to have all suppliers to the Bell System, whether Western or general trade, deal through the Entity for sales of the products and services to the Bell System.

Concerns and FCC intent

In the record in FCC Docket 19129, the subject of procurement activities and capabilities of the Bell Operating Companies (BOC's) was developed at length on the record. In the March 1, 1977 decision issued in Phase II of this docket, the FCC, after considerable comment on the record showing in this regard, ordered as follows at Paragraph 324:

"* * * Accordingly, it is ordered, That within 90 days of the release date of this Decision the Bell System Respondents shall submit a proposal, including a time frame for implementation, of organizational and functional changes within the present Bell System structure which will satisfy our concerns regarding the lack of autonomy and independence, both joint and individual, given the Bell Operating Companies (BOCs) in equipment procurement; *which will insure that the BOCs deal on an arm's length, fair and equal basis with both the general trade and Western in procurement matters* * * *" (Emphasis added.)

What the FCC obviously intended by this language was that the treatment afforded general trade suppliers with respect to the purchase and use of their products within the Bell System was to be on an *equal* basis to that given AT&T's integrated manufacturing organization, the Western Electric Company (Western). The FCC is clearly concerned with the favored position enjoyed by Western within the Bell System and, because of that position, its proven ability to dominate the provision of telecommunications equipment to the Bell Operating Companies. Additionally,

² Id. at 2-22, 2-23.

Western directly and through its half ownership control of Bell Telephone Laboratories (BTL), participates in the evaluation and testing of general trade products (with which Western products compete) and undertakes the actual procurement of those general trade products, when such is done, for the Bell Operating Companies. The FCC felt that the record developed in this docket showed that this organizational structure and operational arrangement within the Bell System gives Western effective control over essentially all equipment used in the Bell System with the result that Western's equipment is used predominately, and with some product classes exclusively, by the BOCs.

The FCC was concerned that this control by Western might retard or impede technological innovation and development of telecommunications equipment; that it might result in the delay in the introduction of advanced equipment capable of providing improved performance and/or additional features and user benefits, and furthermore could act to raise the cost of telecommunications services. Therefore, in its ordering paragraph, the FCC directed AT&T to develop a proposed structure to insure greater autonomy for Bell Operating Companies, collectively and individually, so that they might make their own evaluations of both general trade and Western products; to make so-called make-or-buy decisions, to determine whether to buy products from outside sources or from the integrated Western affiliate; and to enable them to undertake the actual procurement of selected equipments including the ability to inspect products purchased prior to use within their systems.

AT&T proposal

On May 31, 1977, AT&T did propose a restructuring of its centralized procurement activities in response to the FCC Order in Phase II of 19129. That proposal was for the establishment of an Entity headed by an individual at an executive level commensurate with that of the top executive level of the Bell Operating Companies. This centralized Entity would act in determining requirements of the various Bell Operating Companies for telecommunications equipment and supplies; would seek out or identify opportunities for such equipment and would evaluate general trade products to satisfy those identified opportunities; and would enter into contracts and purchase agreements with the general trade for the purchase and supply of general products for the identified Bell System requirements.

The initial proposal was very general and lacked significant detail. It basically called for the establishment of a group that will be made up predominately of the same people currently involved in Western's procurement activities for the BOCs, as well as those people currently involved in the activities of the Bell System Purchased Products Division (BSPPD) of AT&T's General Department. This centralized agency would act on behalf of the Bell Operating Companies in procurement matters.

The basic criticism against the AT&T proposal was that, in effect, all AT&T was doing was merely giving a different name to slightly reorganized procurement activities. It was argued that this would be nothing more than a re-shuffling of the same individuals with the net result being that the procurement activity within the Bell System would remain essentially as it is today with Western remaining in a predominate position.

In March of 1978, the FCC Common Carrier Bureau, acting in accordance with directions from the Commission, set forth an extensive listing requesting necessary clarification and additional information on the AT&T proposal. On May 22, 1978, AT&T responded to the Common Carrier Bureau request. The purpose of these comments is to discuss some of the specific statements made in that AT&T response as well as to comment on the concept proposed by AT&T.¹

Basic flaw of AT&T proposal

The language of the FCC's Order was unquestionably clear that the required restructuring was to assure that the Bell Operating Companies would be dealing on an arm's length, fair and equal basis with both the general trade and Western in equipment procurement matters. The basic flaw of the AT&T proposal is that it fails to meet this essential objective of the FCC's Order. There is no way that equitable treatment can be provided to the general trade and Western when general trade vendors are required to deal through a centralized agency, whether it is called an Entity or Bell System Purchased Products Division or by some other name, while Western deals directly and intimately with the Bell Operating Companies. This

¹ As with previous IDCMA submissions, this statement primarily concerns the data communications equipment area and comments are directed specifically to and in regard to that area of telecommunications equipment and facilities. While it may or may not apply to other types of telecommunications equipment, IDCMA is not taking a position with regard to those other telecommunications equipment areas.

relationship is not limited to procurement, but includes involvement in developing equipment plans and requirements, in stocking and repair of equipment, as well as in the evaluation and inspection of general trade products. For this reason alone the AT&T proposal should be rejected by the Commission as it fails to meet the primary objective of the Docket 19129 decision.

Discussion of deficiencies

It appears that the proposed Entity is really in only one regard different from the present Bell System Purchase Products Division. This difference is that the new Entity would have the authority to make purchase commitments on behalf of the Bell Operating Companies. The BSPPD does not have requisite authority to make such commitments today. In other significant regards, the proposed Entity and the present BSPPD are essentially the same. As brought out in the record of Docket 19129, and based on information available subsequent to that time, the performance of the BSPPD in regard to procurement and use of general trade products within the Bell System has been quite unimpressive. In those cases where general trade products have been evaluated for use within the Bell System, the time involved in evaluation of those products far exceeds what should be reasonably expected. Even when a general trade vendor successfully goes through the Bell evaluation process with a product, and then possibly enters into a general contract covering terms and conditions of sales of such product to the Bell System, there is no assurance whatsoever that a Western product will not be given favored treatment over the general trade supplier's evaluated product, even if the Western product is functionally inferior. Further, there is no assurance that any purchase of the general trade product will ever be forthcoming. Experience has shown that the time required from the identification of a candidate general trade product through its evaluation, testing, acceptance for use within the Bell System and finally the contracting process takes far too long, particularly considering the rapid technological changes occurring in telecommunications equipment today. This extended time period results in the general trade product vendor missing opportunities for the sale of his product within the Bell System.

As stated above, the basic problem with the proposed restructuring for BOC procurement activities is that there is disparate treatment between Western and general trade vendors. This is significant in many aspects. First, Western will continue to receive advanced planning information not available to general trade vendors. Western actually participates, and would continue to participate, in the planning meetings with the BOCs and AT&T. Western, therefore, is and will be aware of requirements well in advance of the time that any information concerning opportunities and requirements is made generally available, via the proposed Entity or BSPPD, to general trade suppliers. The availability of this advanced planning information to Western is a significant advantage in many respects. Western can participate in the development of equipment to meet new planned service offerings of the Bell System and such participation is on an essentially sole-source basis. As general trade companies are not part of or privy to this advanced planning information, equipment concepts and technology developed by independent general trade suppliers are not and will not be given any consideration in the early planning stages of new Bell service offerings. A case in point is AT&T's Dataphone Digital Service (DDS) which utilizes specially developed multiplexing equipment. The equipment used by AT&T in the DDS offering was totally developed by Western and purchases of that equipment have been sole-source from Western. Additionally, exclusion of general trade vendors from the early discussion concerning DDS service and equipment requirements made it impossible for general trade suppliers to contribute ideas which may have enabled AT&T to provide lower cost and/or higher performance DDS services. Also, because of their exclusion, these suppliers may be unable to support independent telephone companies who are or will be also participating in the provision of DDS services.

A second significant advantage Western has, because it does obtain advanced BOC/AT&T planning information, is that it can develop its manufacturing schedules and pricing based on forward-looking, forecasted requirements and it can actually produce equipment in advance of orders or firm commitments from the Bell Operating Companies. While the AT&T proposal tries to imply that this gearing up in advance may be at a risk to Western, in all practicality, once Western has geared up, with or without firm commitments from the Bell Operating Companies, experience has shown that the BOCs do in fact purchase from Western in accordance with such pre-existing verbal commitments. At one point in the proposal discussing procurement commitments on the part of the Bell Operating Companies, it is stated that these long term commitments are a risk to the Bell Operating Companies. While it may appear that Western is the one taking the risk, in fact the marketing risks are borne by the Bell Operating Companies.

A third significant advantage which Western enjoys is in the area of standardization. By and large, those equipments that are standardized for use in the Bell System are of Western design and/or manufacture. While the significance of having a product standardized is not brought out in the proposal, it is understood that once standardized, a product is provided with total AT&T product support. This would include support of the Marketing personnel within the General Departments of AT&T in the promotion of the product and the services utilizing the product. It also includes support from Bell Telephone Laboratories in regard to advice as to changes in the telecommunications network that might impact the design of standardized products. Also, even though a general trade product may become standardized, and to our knowledge no general trade data products are Bell System standardized to date, AT&T can still decide to internally develop a similar product. In fact, in Appendix II of AT&T's Response,² it is stated that AT&T may standardize on a product for current Bell System use and also direct BTL and Western to begin development of a product that is expected to be better or cheaper at some later point in time. It is obvious from this that while the Bell System may standardize on a general trade product it may also develop its own product to replace the standardized general trade product if the volumes are expected to be significant. Since Western would develop and manufacture these products and sell them in quantity to the Bell Operating Companies, it is expected that Western would in all likelihood be able to offer them at an apparently "cheaper" price than a general trade product sold in lower volume. This apparently "cheaper" Western price would not only be possible because of the significantly higher volume purchased from Western for which the general trade vendor would no longer be considered, but also because of the inherent ability of Western to cross-subsidize within its broad product line classification to achieve its pricing goals for a given product. Therefore, while AT&T may standardize on and purchase general trade products initially when the volume is low, if and when that volume increases, AT&T has announced its intent to develop its own Western product to replace the general trade item without the benefits of competitive bidding through the auspices of the new Entity.

Another reason for Western's favored position with the BOCs is that Western maintains stocks of BOC owned products for the BOCs in Western distribution centers. Western also repairs and refurbishes such products between service requirements for the Bell Operating Companies. These activities, only available from Western, are all charged to the BOCs. This further "ties" the BOCs to and makes them dependent upon Western. In Appendix I of AT&T's Response,³ it is stated that one of the advantages of the Entity to the BOCs is that it will act as a distributor for general trade products. As noted earlier, Western's position is enhanced because, in its relationship with the Bell Operating Companies, it acts as a stocking distributor for the products it sells to the BOCs. However, even though the Entity acts as a "distributor" there is no mention of its receiving remuneration from the BOCs, as it does with Western, for its functioning as a stocking distributor for the general trade products which it procures. Stocking is a significant consideration, particularly, since the Bell Operating Companies are accustomed to dealing with Western who offers stocking for its products. This stocking function could include repair of equipment and Class C-stock type inventories such as those maintained by Western for Bell Operating Company owned equipment returned to Western for repair and service inventory.

Summary and conclusions

The basic problem with AT&T's proposal for the establishment of an Entity to deal with general trade suppliers is that the proposal does not provide for equitable treatment of general trade suppliers vis-a-vis Western as specifically required by the FCC Order. The establishment of an Entity within AT&T would only have meaning if Western likewise dealt through the Entity for the sales of its products to the Bell System. The Entity should be established so as to be in a position to provide meaningful, timely information regarding forecasted requirements, etc., to all potential suppliers to the Bell System, both general trade and Western. This information should be provided to both general trade suppliers and Western in the same form and content and *at the same time*. The Entity should provide for participation by both the general trade suppliers and Western in discussions regarding future service plans of the Bell System so that the capabilities, products and technological concepts of the general trade suppliers can also be considered for possible application in fulfilling the equipment requirements of such future service offerings of the Bell System. The Entity should be the point of contact for both general trade suppliers

² Appendix II, p. 2.

³ Appendix I, p. 19.

and Western in regard to product evaluation and product standardization activities. The Entity should act as the stocking distributor for the Bell Operating Companies and should develop standard supply contracts for use *both* with Western and general trade suppliers concerning the provision of equipment to the Bell Operating Companies. The Entity should probably also have a repair capability and an inventory stocking (Class C-stock type) capability. While the general trade suppliers and Western should be free to deal directly with the Bell Operating Companies themselves, arrangements must assure equitable treatment for both the general trade suppliers and Western.

Bell Telephone Laboratories will be involved in evaluation of products for use by the Bell System and will provide inputs to the standardization decision process. Therefore, it should either be completely divorced from Western or that portion of the Bell Labs involved in these activities should be separated so that capability can be incorporated within the Entity's organizational structure. The Entity should have the capability and ability, in addition to purchase of products, to contract with Western and general trade suppliers on a competitive evaluation basis for the research and development of future product requirements.

To conclude, it is felt that AT&T's proposed reorganization to establish an Entity only for procurements from general trade suppliers fails to fulfill the requirements specified in the FCC's decision in Docket 19129. The only way that the equal treatment required by the FCC Order can be achieved is to have all suppliers to the Bell System, whether Western or general trade, deal through the Entity for: (1) sales on a system-wide basis of products and services to the Bell System, (2) Bell System product standardization activities, (3) participation in the development of equipment to meet new planned Bell System service offerings, (4) stocking and repair of Bell System procured products, (5) hardware research and development, and (6) receipt of Bell System advanced forecasting and other planning information.

Respectfully submitted.

IDCMA TECHNICAL COMMITTEE.

APPENDIX C

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, D.C.

RM 3308

In the Matter of Regulatory and Policy Problems Presented by the Interdependence of Terminal Telephone Equipment Sales and Communications Services and Facilities

REPLY COMMENTS

The Independent Data Communications Manufacturers Association, Inc. (IDCMA), by its attorneys, pursuant to the Commission's invitation, herewith submits its reply comments in the captioned proceeding.¹

I. INTRODUCTION

IDCMA is comprised of data and computer communications equipment manufacturers, none of whom are affiliated with telecommunications common carriers. IDCMA member companies compete with telecommunications common carriers in the terminal equipment market. Consequently, matters involving the structure and regulations under which common carriers market terminal equipment are of direct interest to the Association.

IDCMA is an advocate of free enterprise and supports the concept of full and fair competition. The very existence of many IDCMA member companies has been enhanced by the degree of competition which now exists in the provision of data and computer communications equipment.²

Benefits to consumers resulting from competition in the provision of terminal equipment stand uncontroverted. Competition has fostered increased innovation, lower costs and has encouraged suppliers to meet specialized consumer needs that

¹ See FCC Public Notice, Mimeo No. 10860 (Dec. 21, 1978), as modified by FCC Public Notice, Mimeo No. 11861 (Jan. 24, 1979); FCC Public Notice, Mimeo No. 11981 (Jan. 30, 1979). On Mar. 13, 1978, time for filing reply comments was extended from Mar. 14, 1979 to Apr. 4, 1979. See FCC Public Notice, Mimeo No. 13469 (Mar. 15, 1979).

² Competition in the terminal equipment market was originally introduced by the Federal Communications Commission's (FCC) landmark *Carterfone* decision. See *Carterfone*, 13 F.C.C. 2d 420, *reconsideration denied*, 14 F.C.C. 2d 571 (1968). In fact, competition to the degree it now exists in the domestic telecommunications industry has resulted from FCC action.

otherwise might have gone unsatisfied.³ Further, competition from independent equipment suppliers has obliged common carriers to become more responsive to consumer needs.⁴ Thus, as the Department of Justice concluded in the Commission's NTS/WATS market structure inquiry:

"[E]ach time the Commission has relied on competition as a regulatory tool, it has met with substantial success. The Commission's landmark *Carterfone*, *Specialized Carriers*, and *Domestic Satellites* rulings have all had very clear and positive effects from the public's standpoint. Prices for services decreased, the range of options greatly increased, and the rate of innovation proceeded much faster."⁵

As explained in its initial comments, IDCMA is concerned that various State proposals to permit monopoly carriers to offer terminal equipment without adequate regulatory supervision may unlawfully conflict with basic Federal policy and may pose a significant threat to full implementation of Commission policies facilitating competition. Based on a review of the comments and early filed reply comments submitted by certain participants in this proceeding,⁶ IDCMA's concerns have not been assuaged. To the contrary, the comments and replies of some carrier parties—most notably General Telephone and Electronics (GTE)—attempt to induce a state of hysteria which those parties apparently hope will result in tacit Commission approval of inconsistent, piecemeal State actions that threaten to disrupt and possibly destroy the competitive terminal equipment marketplace. Rather than proceeding in the manner suggested by the carriers, the Commission should evaluate the very real problems presented by these inconsistent State proposals and should provide an appropriate mechanism for resolving them. Contrary to the assertions of the carriers, the public will be better served if the Commission proceeds toward a careful resolution of these issues which promotes competition and eliminates the use of monopoly power to influence or control subscriber purchases of terminal equipment.

In order to appreciate fully the nature of the problems involved, it is necessary for the Commission to keep in mind the unique structure of the domestic telecommunications marketplace, the powers which monopoly carriers enjoy, and the potential which exists for abuse of those powers.

II. BACKGROUND

A. Unique market structure

The unique market structure of the domestic telecommunications industry was described in recent remarks by Senator Ernest Hollings, Chairman of the Senate Subcommittee on Communications. In introducing S. 611,⁷ a bill which promises to significantly amend the Communications Act of 1934, Senator Hollings noted:

"We cannot ignore the overpowering presence of integrated monopoly carriers—particularly A.T. & T., the world's largest corporation. Although full competition is ultimately feasible in most telecommunications markets, it does not currently exist. Nor, will it come into being overnight simply because Congress declares it to be national policy. Easy entry by competitors is a prerequisite for a fully competitive market. *Yet if all regulation were removed, existing telephone monopolies and especially A.T. & T. could hinder entry into many if not most telecommunications markets because of their size, market presence and because they control access to the existing network.* These companies are not to be criticized because of their overwhelming market power. It was in large part a deliberate result of prior policies which were appropriate at the time they were designed.

"However, as the 1934 policies are modernized, *this market dominance is a fact which must be faced and addressed. While some potential competitors may be able to hold their own against A.T. & T. in totally unrestrained market (e.g., IBM, Xerox [sic], RCA), many could be crushed before they had a chance, and even the large ones might well be unable to withstand the advantages the existing telephone monopoly enjoys as a result of the peculiar history of the last 45 years.*

"On the other hand, some observers argue that A.T. & T. is handicapped rather than aided by the huge albatross of "obsolete" plant which is not fully depreciated and can only be very slowly unwound because of regulatory constraints and tariffs, construction, and depreciation rates. While there is probably some truth to this, *it is*

³ See, e.g., *Customer Interconnection*, 61 F.C.C. 2d 766, 865-67 (1976).

⁴ Id. at 865-66 (discussion of modem market).

⁵ Initial comments of the U.S. Department of Justice in FCC docket CC 78-72 at 41 (July 12, 1978).

⁶ On Mar. 14, 1979, GTE and A.T. & T. filed reply comments. KLF Electronics (KLF) also submitted reply comments on that date.

⁷ See S. 611, 96th Cong., 1st sess. (1979).

*doubtful that it outweighs the tremendous power which A.T. & T.'s position confers. Because of this power, the potential risks of unfettered entry by A.T. & T., and other large regulated telecommunications monopolies, into competitive markets are so huge and unforeseeable that it would be irresponsible to totally deregulate such markets on the naive belief that full and fair competition would magically appear overnight."*⁸

While designed to facilitate competition, S. 611 recognizes the need for adequate regulatory supervision and structural safeguards to be imposed in the event monopoly carriers participate in competitive markets. Thus, as described by Senator Hollings,

"The heart of the bill is the establishment of a procedure which systematically identifies major markets and submarkets within the telecommunications equipment and service industries and establishes the conditions under which carriers may participate in these markets. *These conditions for participation are designed to preserve competitive market conditions where they exist, and to foster them where they are possible.* The nature and scope of regulatory supervision is adjusted to suit actual market conditions and public interest concerns. This proceeding would begin with a classification by the Commission of services and carriers based on the degree of competition and the extent to which particular services are so essential to the public interest that their availability at reasonable rates must be assured.

"* * * Under this bill A.T. & T. would be allowed to enter any market it wishes—including unregulated information services. However, if it chooses to enter a competitive market it would have to set up a "fully separated subsidiary." A "fully separated subsidiary" is one which is owned or controlled by another entity but does not have common directors, officers, employees or financial structure or commonly owned facilities, and which deals with its parent or affiliate on an arms length basis in the same manner as it deals with any unaffiliated entity. In other words, if AT&T wished to enter the information services market they would have to set up a separate subsidiary. If the subsidiary wished to use telecommunications facilities owned by its parent, another affiliated entity, or nonaffiliated entity, would have to do so by leasing these facilities on a basis which does not discriminate in favor of that subsidiary."

The perceptive nature of Senator Hollings' characterization of the market, the power of monopoly carriers, the havoc that instant deregulation would wreak and the need for adequate regulatory supervision and safeguards if monopoly carriers are to participate in competitive terminal equipment activities are readily apparent. Telephone common carriers have a transmission facilities monopoly within their local exchange areas. This monopoly empowers such carriers to condition or otherwise to affect the quality as well as the quantity and the timeliness of service delivered to subscribers. By virtue of their control over these factors, carriers can tie the provision of service to subscriber use or purchase of telephone company-provided terminal equipment. Since terminal equipment, whether customer or telephone company-provided, must be used in conjunction with monopoly transmission facilities, telephone companies have the ability to control the use of customer-provided equipment supplied by their competitors.¹⁰ Thus, carriers are in a position either to directly coerce subscribers into using carrier terminal equipment or to exert more subtle pressures to oblige subscribers to use carrier-provided equipment. Further, unlike their competitors, common carriers can use revenues derived from rates paid by monopoly service users to cross-subsidize or to underprice terminal equipment which they supply. Indeed, common carrier terminal equipment activities are rife with actual and potential abuses of monopoly power.

B. Problems and abuses inherent in carrier terminal equipment sales activities that are not adequately supervised or subject to structural safeguards clearly demonstrate the need for Commission action

Any doubts concerning actual or potential abuses inherent in monopoly common carrier terminal equipment sales activities that are no subject to adequate regula-

⁸ 125 Cong. Rec. S2502-03 (daily ed. Mar. 12, 1979) (remarks of Sen. Hollings) [emphasis added].

⁹ Id. [emphasis added].

¹⁰ Customers may perceive, for example, that control of local exchange facilities enables a carrier to provide users of its equipment with "selected" higher grade local loops than would otherwise be randomly assigned by the carrier should the subscriber elect to provide his own equipment. Such perceptions can be used or played upon to dissuade subscribers from employing independently supplied equipment. Further, telephone companies also are in a position to affect the quantity, maintenance and timeliness of service received. These factors can be similarly used to dissuade subscribers from utilizing independently supplied equipment.

tory supervision or structural safeguards are quickly dispelled by examples of such abuse contained in comments submitted in this proceeding. Executone, for example, has cited a number of abuses arising out of the relationship between Rochester Telephone Corporation and Rotelcom, a wholly owned Rochester Telephone Corporation subsidiary created with monopoly revenues that engages in terminal equipment sales.¹¹

While IDCMA is not in a position to attest to the substance of Executone's allegations,¹² IDCMA's own comments present an extensive discussion, based on evidence of record in Docket 19419, of abuses and adverse impact stemming from AT&T's ability to cross-subsidize research and development, manufacture, advertising, sales and provision of terminal equipment. Thus, contrary to the allegations made in AT&T's reply comments,¹³ the concerns expressed are not conjectural but rather are based on documented fact.

The comments of the carrier parties also provide examples of the serious problems and abuses which arise when regulated monopoly carriers engage in terminal equipment sales. For example, Continental Telephone Corporation (Continental) admits that carriers cross-subsidize terminal equipment sales by comingling monopoly service investments, revenues, marketing and maintenance personnel to support so-called "competitive" terminal equipment activities:

"Petitioners would also have the Commission deny the consuming public the cost efficiencies which can be achieved by spreading such fixed costs over the entire range of terminal equipment options. By utilizing their marketing system and investment, common carriers can offer consumers lower purchase prices. If the carriers are confined to tariff offerings (or are required to duplicate their marketing system and investment), then the ratepayers must bear the entire burden and possible cost efficiencies are eliminated.

*"The suggestion that the telephone company should create two parallel marketing and maintenance staffs and facilities—one to handle tariffed equipment and the other to handle sale or leased equipment—demonstrates just how illogical the present semiregulated terminal market is."*¹⁴

The impropriety of what Continental admits is being done convincingly demonstrates the need for uniform, adequate regulatory supervision and structural safeguards for monopoly carrier terminal equipment activities. Even Mr. Neil A. Swift, Director of the Communications Division of the New York Public Service Commission (NYPSC), whose views on the subject matter of this proceeding are well known, agrees:

"We must insure that Bell and all others compete fairly. This means continuing regulatory oversight and review of investment and cost allocation. It would be pointless to let the Bell System sell off its in-place terminal equipment at a loss in the name of competition. The probable result would be the elimination of competition, a de facto monopoly, and a revenue requirement to be borne by the monopoly ratepayers. The point is that regulators must take an active role in both promoting

¹¹ According to a report appearing on page 19 of the Feb. 19, 1979 NARUC Bulletin, NARUC No. 8-1979, Rochester Telephone will invest up to \$2.2 million of its revenues in Rotelcom.

¹² Concerns like those of Executone have also been expressed by KLF Electronics which competes with General Telephone Co. of Indiana in the marketing of telephone terminal devices. See KLF reply comments at 1-2.

¹³ See A.T. & T. reply comments at 1-2. Where vertically integrated monopoly carriers such as AT&T and GTE are involved, it is important to recognize that inadequately supervised monopoly carrier terminal equipment sales could directly affect the consumer through decreased competition. For example, Bell System operating companies purchase equipment almost exclusively from Western Electric. If monopoly carriers are permitted to engage in inadequately supervised terminal equipment sales, there is no reason to expect that major changes will be made in the procurement policies of their affiliated operating companies. Therefore, the manufacturing arms of these vertically integrated monopoly carriers will continue to retain a captive market of affiliated carriers. Consumer choice may also be inhibited by monopoly carrier cross-subsidization of terminal equipment manufactured by a subsidiary and sold without adequate regulatory supervision by affiliated operating companies. Consumers, in turn, would not receive the benefits of greater choice, true cost efficiencies and increased innovation which competition in the supply of such equipment would otherwise occasion. Accordingly, monopoly carrier equipment procurement policies and the "preference" which monopoly carrier operating companies have for equipment supplied by the parent monopolist's manufacturing arm are areas which should also be evaluated.

It should be noted that the judgment recently entered in *ITT v. GTE* requires GTE operating companies to discontinue their former practice of purchasing telecommunications equipment on a preferential basis from GTE affiliated equipment manufacturing companies. See *ITT v. GTE*, No. 2754 (D. Haw. Dec., 20, 1978). Further, the Commission's order in Docket 19129 directed the Bell System to develop procedures that would allow Bell System operating companies to have more autonomy in making procurement decisions. See AT&T, 64 F.C.C. 2d 1, 45 (1977).

¹⁴ Continental Telephone Corp. (Continental) comments at 20 [emphasis added].

competition and the necessary follow-up to insure that the competition is real. And it must be done on the local level."¹⁵

Thus, Mr. Swift recognizes the need for continuous, uniform regulatory supervision and safeguards. His conclusion, however, that this can be done at the local level is inconsistent with the fact that the state proposals at issue are "devoid of any coherent policy."¹⁶ Rather, the uniform regulatory supervision and safeguards which Mr. Swift states are necessary can only result from FCC action. In fact, FCC action is the only way to ensure that necessary uniformity will exist and be enforced.

Another compelling reason dictates Commission attention to the matters at issue in this proceeding. As recognized by GTE, many states "may or may not have [regulatory authority] over carrier sales of terminal equipment."¹⁷ While uncertainty surrounds the authority of the various states to regulate carrier terminal equipment sales, it is clear that those states which have looked at the matter are taking totally disparate approaches. Florida and New York, for example, are investigating the problems posed by such sales.¹⁸ Pennsylvania, on the other hand, apparently lacks authority to regulate carrier terminal equipment sales.¹⁹ Missouri seems to have decided not to assert jurisdiction.²⁰ Texas, while claiming not to have regulatory authority over carrier terminal equipment sales and sale prices, takes the position that it can take profits or losses from such sales into consideration when setting rates.²¹ Thus, as recognized by Continental, the various state proposals are indeed "devoid of any coherent policy."²²

It is equally clear that the states simply do not have mechanisms in place to adequately supervise and regulate carrier sales of terminal equipment. Given differences in state statutory authority and the inconsistency of the respective state proposals, it is also obvious that the states will be unable to develop and to implement a uniform method of meaningful, continuous supervision. Therefore, the Commission should provide such standards or at a minimum provided necessary guidance before the state proposals are implemented. Even AT&T recognizes the need for the Commission to act first in order to provide guidance to the states about appropriate methods of cost allocation:

"The Commission in CC Docket No. 78-196, dealing with the revision of the Uniform System of Accounts for Telephone Companies, has inquired concerning the creation of several new accounts to record revenues and expenses associated with the sale of terminal equipment by telephone companies. Such changes in the accounting system will better enable state regulatory commissions concerned about the possibilities of cross-subsidization to audit more readily the accounts of telephone companies subject to their jurisdiction."²³

Therefore, it is necessary for the Commission to assess not only the propriety, or lack thereof, of the state proposals but also to develop uniform regulatory guidelines and safeguards in the event that monopoly carriers are to be allowed to make direct sales of terminal equipment.

Mindful perhaps of the need for the Commission to act first in order to introduce uniformity, the carriers go to great length to represent the Commission's current

¹⁵ Swift, Neil A., "Thoughts on Regulation" at 6 (delivered before the Fifth Annual Symposium on Ratemaking Problems of Regulated Industries, Feb. 13, 1979) (emphasis added). Mr. Swift is the author of the terminal equipment deregulation proposal that is currently the subject of proceedings in NYPSC Case 27415. Mr. Swift's concerns about letting carriers sell off in-place terminal equipment are very legitimate. GTE, for example, has argued that it ought to be able to sell off in-place equipment. See docket 20981, GTE Comments at 11-12 (March 1, 1979).

¹⁶ Continental Comments at 21.

¹⁷ GTE Service Corp. (GTE) Opposition at 9-10. The "Petition for Declaratory Ruling" which led to the initiation of this proceeding noted State proposals from New York, Nevada, Florida and Pennsylvania. See RM-3308, Petition for Declaratory Ruling (Petition) at 16-18 (Nov. 14, 1978). In its comments, IDCMA pointed out that subsequent to the date of petitioners' filing, General Telephone of Kentucky submitted a tariff sheet cancelling its existing data terminal rates, rules and regulations and substituting individual "customer contracts" in lieu of the usual tariff procedure for carrier/supplied terminal equipment. See IDCMA Comments at 4-5, 10-11. Although the Kentucky Public Service Commission has suspended the effective date of that proposal until April 27, 1979, there is a grave possibility that the proposal may be implemented within the relatively near future. In its March 1, 1979 comments in Docket 20981, GTE noted that West Virginia, Michigan and Wisconsin are now investigating the question of carrier sales of terminal equipment. See Docket 20981, GTE Comments at 5.

¹⁸ See GTE Opposition at 8.

¹⁹ See Central Telephone & Utilities Corp. (Centel) Comments at Exh. B.

²⁰ Id. at Exh. D.

²¹ Id. at Exh. A.

²² Continental Comments at 21.

²³ AT&T Comments at 11 (emphasis added).

Uniform System of Accounts (USOA) proceeding as a panacea rendering unnecessary any further Commission action.²⁴ While IDCMA full supports and is participating in the Commission's USOA proceeding, attempts by the carriers to portray the USOA revision process as an immediate solution for the matters at issue here are misleading. For one thing, the revised USOA is not yet in place.

As evidenced by recent Commission comments, revision of the USOA may take an indeterminate amount of time.²⁵ In fact, several of the carrier parties in this proceeding have stated that it will take many years to revise and implement changes in the USOA.²⁶ Thus, if the Commission at this time foregoes taking action on the matters at issue, it is clear that a very serious, potentially fatal void would exist during which the competitive terminal equipment market could conceivably be destroyed.

It is particularly disingenuous for the carriers—especially GTE—to allege that USOA revisions will satisfactorily resolve all problems stemming from inadequately supervised monopoly carrier terminal equipment sales activities.²⁷ For example, GTE in this proceeding extols state²⁸ and Commission USOA²⁹ efforts to resolve cost allocation problems. Yet, in the Commission's USOA proceeding, GTE repeatedly has urged that meaningful cost accounting requirements should not be imposed on monopoly carrier "competitive services."³⁰ Further, at the state level, GTE has actually taken steps to block public disclosure of terminal equipment cost information.³¹ Thus, GTE's true disdain for having to meaningfully and publicly account for its terminal equipment sales activities even at the state level is readily apparent. In fact, GTE's actions at the state level not only contradict its allegations in this proceeding about the effectiveness of state commission efforts to establish cost allocation monitoring mechanisms but also serve to emphasize the need for uniform, federal guidelines to apply to monopoly carrier terminal equipment activities.

It should not escape notice that even carriers recognize the need for uniform guidelines to be established. For example, Continental has admitted that:

"If regulated telephone companies are to engage in nonregulated activities without being hampered by constant argument over cost allocations, *clearly defined cost allocation guidelines and accounting practices must be clearly established prior to telephone companies' entry into the competitive marketplace.*"³²

Clearly then, it is the Commission which must act to bring uniformity out of the dangerous chaos that now exists.

While some carriers may recognize the need for regulatory supervision of their terminal equipment activities, carrier comments indicate total disagreement about whether, how and to what extent, this should be done. Indeed, some of the arguments advance by the opponents of regulatory supervision can only be described as bizarre. Consider, for example, the Rochester Telephone position that because of economic reasons, telephone company cross-subsidization of terminal equipment is impractical.³³ In advancing this unique position, Rochester states that "[e]ven if a telephone company could drive out its current interconnect competition, any attempt to raise prices would be inevitably followed by new entry because the costs of

²⁴ See, e.g., AT&T Comments at 11-12; United Telecon Service, Inc. (United) Comments at 3-5.

²⁵ See, e.g., CC Docket 78-196, *Memorandum Opinion and Order* (Mimeo No. 13111) at ¶ 2 (released March 7, 1979); CC Docket No. 78-196, *Memorandum Opinion and Order* (Mimeo No. 12854) at ¶ 3 (released Feb. 27, 1979). In denying requests for extensions of time for submission of reply comments, both of these orders state that subsequent notices will be issued in the proceeding to permit interested parties to file additional comments.

²⁶ GTE, for example, cites with approval the Price Waterhouse estimate that a revised USOA will take eight to twelve years to implement. See CC Docket No. 78-196, GTE Reply Comments at 19 (Mar. 15, 1979). GTE also "estimates that a minimum of four to five years will be required to modify [GTE's] standard financial system * * * [and] [i]n addition, an undetermined period of time will be required to install the modified system in each of GTE's operating companies." *Id.* Continental, on the other hand, estimates that the USOA revision process "could take as long as 10 to 15 years." See CC Docket No. 78-196, Continental Comments at 20 (Jan. 15, 1979).

²⁷ See n. 17 *supra* and accompanying text.

²⁸ See GTE Opposition at 19.

²⁹ See *id.* at n. *

³⁰ See CC Docket No. 78-196, GTE Comments at 3, 4 (Jan. 15, 1979). In its recent USOA reply comments GTE reiterated that:

"GTE continues to believe that competitive aspects of its operations will be regulated by the marketplace and that account level data with respect to competitive services is sufficient for purposes of regulatory oversight."

CC Docket No. 78-196, GTE Reply Comments at 14 (March 15, 1979) (footnote omitted).

³¹ See General Telephone Company of Kentucky Case No. 7281, Tr. at 8-9 (Jan. 15, 1979); n. 17 *supra* and accompanying text.

³² Response of Continental Telephone, New York State Public Service Commission Case 27415—*Deregulation of Terminal Equipment* at 7 (Oct. 26, 1978) (emphasis added).

³³ See Rochester Telephone Corp. (Rochester Telephone) Comments at 12-13.

entering the market are verily low.”³⁴ Rochester asserts that ease of market entry will serve to discourage telephone companies from engaging in predatory pricing.³⁵ The Commission need only look at the record compiled in Docket 19419 and elsewhere to explode the Rochester “myth.”³⁶

It is equally apparent that the problems discussed here would not be resolved satisfactorily even if each state were to adopt its own way of proceeding. Rather, such a course would only result in a multiplicity of disparate standards that could not possibly serve the public interest. It is obvious therefore that necessary uniformity could never be achieved in such fashion. Further, as pointed out in IDCMA’s comments, inconsistent state proposals to allow monopoly common carriers that are subject to the Commission’s jurisdiction to sell terminal equipment without adequate regulatory supervision and structural safeguards may also upset existing separations and settlement procedures.³⁷ Remedies proposed for consideration in Docket 20981, the Federal-State Joint Board proceeding that is now evaluating the impact of terminal equipment competition and the need for revisions, if any, to jurisdictional separations procedures to ameliorate such impact, thus may be affected or even nullified by these state proposals. Commission proceedings to revised the USOA also stand to be adversely affected.³⁸ Finally, Commission consideration of AT&T’s proposal to alter treatment of installation costs for station equipment similarly may be impacted.

In addition to the need for the Commission to assess the implications which these state proposals may have in terms of current Commission proceedings and substantive policies, there is yet another compelling reason why Commission action is necessary. As noted, the state proposals at issue here are inconsistent or in Continental’s words are “devoid of any coherent policy.”³⁹ Conflicting state policies on carrier sale of terminal equipment will adversely affect terminal equipment competition. This fact is expressly recognized by Mr. Neil A. Swift, who has stated:

“Deregulation of terminal equipment and its consequent removal from interstate consideration could bring about a reduction in interstate revenue requirements, interstate revenues and subsequently a reduction in the revenues now flowing to basic exchange service. In New York, for instance, if we and only we removed terminal equipment from the jurisdictional separations base, approximately \$250 million of New York revenue requirement currently assigned to interstate would revert to intrastate. If this revenue requirement were to be imposed on basic exchange service, the resulting increase would approximate 25%. This is clearly unacceptable.”

*“New York then cannot move forward until one of two conditions are met—all other jurisdictions must move simultaneously or the separations formulae must be revised so that changes in the industry’s terminal equipment investment have no impact on revenues. In the long run the formulae must be changed anyway, as significant changes in the industry’s investment will result from existing regulatory policies.”*⁴⁰

If monopoly carriers are to sell terminal equipment, a nation-wide, uniform set of standards and safeguards is necessary to assure the preservation of competition and to assure that monopoly service ratepayers are not affected adversely.⁴¹ It is the Commission, not the states, which therefore must act to assure the existence and enforcement of a uniform policy. As will be demonstrated in the following discussion, the Commission clearly has jurisdiction over the matters at issue and thus should take appropriate action.

³⁴ Id. at 12 (footnote omitted).

³⁵ Id. at 13.

³⁶ See, e.g., Docket 19419, IDCMA Proposed Finding of Fact and Conclusions of Law (July 10, 1978).

³⁷ IDCMA Comments at 6-7; Computer and Business Equipment Manufacturers Association (CBEMA) Comments at 6-7.

³⁸ As pointed out in IDCMA’s comments, an objective of this proceeding is to prescribe costing methodology that will more accurately determined costs incurred by a carrier in providing a particular service. As the Commission is aware, “deregulation” could provide carriers with a mechanism to mask cross-subsidization and “unless appropriate safeguards are immediately established, these activities [could] render any revision of the Uniform System of Accounts an exercise in futility.” Petition, n. 17 *supra*, at 22.

³⁹ Continental Comments at 21.

⁴⁰ Swift, Neil A., *Thoughts on Regulation* at 8 (emphasis added).

⁴¹ KLF’s reply comments point out the need for FDC costs to be used in setting prices for carrier equipment sales and that such sales, if allowed, should be permitted only through separate, arms’ length subsidiaries. See KLF Reply Comments at 2-4.

III. THE COMMISSION CLEARLY HAS AUTHORITY TO ISSUE A DECLARATORY RULING ASSERTING JURISDICTION OVER TERMINAL EQUIPMENT OFFERINGS BY MONOPOLY CARRIERS

A. *The Commission's Wide Latitude in Implementing its Regulatory Goals Clearly Includes Regulation of the Nonutility Activities of Monopoly Carriers*

In Sections I and II, IDCMA has established that the implementation of the various proposals in the state commissions which provide for the offering of terminal equipment without adequate regulatory supervision could thwart or even nullify the effectuation of a number of well-established policies and proceedings of this Commission regarding interstate communications. IDCMA also demonstrated that there is an overwhelming need for the Commission to take immediate steps to protect its well-established policy of assuring that an opportunity exists for fair competition in the terminal equipment field.

In this section, IDCMA will establish that the Commission clearly has the authority to assert jurisdiction over the provision of terminal equipment offerings of common carriers subject to FCC regulation in order to safeguard the effectuation of its regulatory goals.⁴² The Communications Act provides the Commission with the responsibility of assuring "rapid, efficient, nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges".⁴³ As the Supreme Court has consistently recognized, the Communications Act provides this Commission "a comprehensive mandate" with "not niggardly but expansive powers" "to implement its statutory responsibilities. The Act itself authorizes the Commission to: perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions."⁴⁴

The Supreme Court has emphasized that the Commission is given wide latitude over the means by which it assures that the statutory objectives are fulfilled. For example, the Supreme Court has upheld certain regulations regarding CATV systems in order to "promote the objectives for which the Commission has been assigned jurisdiction."⁴⁵ So long as its regulations are "reasonably ancillary" to the "achievement of long-established regulatory goals",⁴⁶ the Commission's regulatory powers have been upheld. If the Commission has jurisdiction to regulate aspects of CATV systems in order to fulfill its statutorily mandated responsibilities, *a fortiori*, it can assume jurisdiction over the actions of common carriers and their affiliates in an area traditionally associated with regulation in order to effectuate well-established communications policies.

Although certain carriers have recognized that their terminal equipment offerings are an integral part of their communications service,⁴⁷ several telephone companies in their initial comments have asserted that this Commission lacks authority to regulate the "non-utility" activities of common carriers subject to FCC regulation.⁴⁸ For example, Central Telephone & Utilities, in attempting to equate the sale by a monopoly carrier of communications terminal equipment to the sale of a "refrigerator, gas stove, blender radio, or microwave oven,"⁴⁹ has made the assertion that this Commission has no authority "to extend its regulatory authority beyond 'communication by wire.'" ⁵¹

The contention that this Commission lacks authority to regulate the terminal equipment offerings of monopoly carriers can only be characterized as frivolous. This argument directly contravenes the long established regulatory experience of this Commission. For many years, a number of carriers have filed tariffs with this Commission governing the terms and conditions of carrier-provided terminal equip-

⁴² In its Comments in Opposition at 3, even Continental Telephone acknowledged that "the Commission may certainly regulate the terminal equipment market". The carrier, however, disputed the authority of the Commission to impose the specific relief requested.

⁴³ 47 U.S.C. § 151 (1976).

⁴⁴ *United States v. Southwestern Cable Co.*, 392 U.S. 157, 173 (1968), citing *Nat'l Broadcasting Co. v. United States*, 319 U.S. 190, 219 (1943); accord *United States v. Midwest Video Corp.*, 406 U.S. 649, 661 *reh. den.* 409 U.S. 898 (1972).

⁴⁵ 47 U.S.C. § 154(i) (1976). See *GTE Service Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973).

⁴⁶ *United States v. Midwest Video Corp.*, 406 U.S. 649, 667, *reh. den.* 409 U.S. 898 (1972).

⁴⁷ *Id.* at 667-68, quoting *First Report and Order*, 20 F.C.C. 2d 201, 202 (1969).

⁴⁸ For example, GTE has asserted that "carriers have supplied terminal equipment to consumers as part of their total communications service offerings". GTE Comments at 18 (emphasis in original). See also AT&T Comments at 3 in which the carrier recognizes that "[t]elephone terminal equipment is an integral part of basic exchange services."

⁴⁹ See United Comments at 9-10 and Central Comments at 4-14.

⁵⁰ Central Comments at 11.

⁵¹ *Id.* at 6.

ment offerings.⁵² Although at times these tariffs have been closely scrutinized and substantial questions have been raised concerning their lawfulness,⁵³ no suggestion has ever been made by this Commission or any party that the Commission lacked jurisdiction over the subject matter of terminal equipment.

This argument also ignores the plain language of the Communications Act, which, by its express terms, applies not only to "communication by wire", but in addition extends to those *entities* which engage in such communication:

"[The Act] shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication."⁵⁴

Obviously, the underscored statutory language would become a total nullity if the Commission's regulatory authority was limited to "communication by wire".

Furthermore, this Commission has asserted jurisdiction, which has been upheld by the courts, over various noncommunications activities of common carriers. For example, in *GTE Service Corporation v. FCC*, 474 F.2d 724, 730 (2d Cir. 1973) a federal court upheld the authority of the Commission to impose restrictions upon the data processing activities of carriers and asserted that:

"The initial question raised by certain petitioners is whether the Federal Communications Commission is authorized by Congress to promulgate rules relating to the entrance of communications common carriers into the nonregulated field of data processing services. We think the answer here has to be in the affirmative."

In fact, this Commission in the past has asserted its authority to investigate certain activities of Western Electric, a terminal equipment manufacturing affiliate of the Bell System.⁵⁵

Certain carriers have contended that it is in some manner improper for the Commission to regulate the terminal equipment offerings of monopoly carriers and leave unregulated the comparable offerings of independent equipment manufacturers.⁵⁶ This assertion is totally without merit. Common carriers have sought and retain valuable monopoly franchises which confer monopoly powers. These carriers have also voluntarily chosen to provide competitive services. The government-sanctioned grant of monopoly power provides an obligation that the carriers' competitive services are not cross-subsidized by monopoly sector revenues. In addition, any carrier which does not wish to be subjected to government regulation can be free from all regulatory restraints by electing to forego its monopoly franchise. In fact, the Commission has recognized the propriety of subjecting monopoly carriers to regulatory supervision which is not afforded to independent manufacturers:

"[T]here is nothing at all improper about common carriers offering under tariff items of communications equipment which may also be available on the market from unregulated suppliers."⁵⁷

Therefore, it is clear that unless there is a specific statutory provision to the contrary, this Commission has jurisdiction over the matters raised in the Petition for Declaratory Ruling in this proceeding.

B. The State Commissions Do Not Have Exclusive Jurisdiction Over Terminal Equipment Offerings

A number of participants have contended that this Commission lacks authority to consider the merits of the Petition because the subject matter is in some manner exempt from the Commission's jurisdiction under Sections 152(b) or 221(b) of the Communications Act. IDCMA will demonstrate that these contentions are utterly without foundation. Before addressing the specific assertions concerning these jurisdictional exemptions, however, it is important to recognize that "the Supreme Court has repeatedly held that exemptions from a regulatory statute are to be strictly construed and that the burden of proof rests upon the party which claims the exemption."⁵⁸

⁵² See, e.g., *In the Matter of A.T. & T. Long Lines Department Revisions of Tariff* FCC Nos. 259 and 260, 33 F.C.C. 2d 518 (1973); *In the Matter of Western Union Telegraph Company Revisions of Tariffs* FCC No. 254, 40 F.C.C. 2d 908 (1973).

⁵³ *Id.*

⁵⁴ 47 U.S.C. § 152(a) (1976) (emphasis added).

⁵⁵ *A.T. & T., The Associated Bell System Companies Charges for Interstate Telephone Service Phase II Final Decision and Order*, 64 F.C.C. 2d 1 (1977) (Docket 19129).

⁵⁶ See, e.g., United Comments at 9-10.

⁵⁷ Brief for FCC and USA, *IBM v. FCC* (Dataspeed 40/4), 470 F.2d 452 (2d Cir. 1978) at 38 n.26.

⁵⁸ *SEC v. American Int'l Savings & Loan Ass'n*, 197 F.Supp. 341, 347 (D. Md. 1961). See, *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953).

A.T. & T.'s assertion that 47 U.S.C. § 221(b)(1976)⁵⁹ prohibits the Commission exercise of jurisdiction over carrier offerings of terminal equipment is without merit.⁶⁰ This statutory exemption provides that the Commission has no jurisdiction over "telephone exchange service" which is subject to state regulation even if such service is provided among several states. Both the plain language and the judicial construction of this statute make it clear that the scope of this statutory exemption only extends to local exchange services. The exemption was solely designed to permit state regulatory agencies to regulate local exchange service in metropolitan areas overlapping state lines. In *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036 (4th Cir.), cert. denied, 434 U.S. 874 (1977), the Court asserted that:

"The term 'telephone exchange service' is a statutory term of art, and means service within a discrete local exchange system. . . . [T]he legislative history of section 221(b) leaves no doubt that the purpose of section 221(b) is to enable state commissions to regulate local exchange service in metropolitan areas, such as New York, Washington or Kansas City, which extend across state boundaries. . . . Section 221(b) simply does not apply to the 'facilities' with which this appeal is concerned."⁶¹

As terminal equipment offered by monopoly carriers is not limited to use in a discrete local exchange system, this statutory exemption to the Commission's jurisdiction has no applicability to this case.

Several carriers have asserted that the offering of carrier-supplied terminal equipment is wholly an intrastate activity and consequently removed from this Commission's jurisdiction by 47 U.S.C. § 152(b)(1)(1976).⁶² This contention, however, utterly fails to take into consideration the nature of terminal equipment. Terminal equipment offerings under intrastate tariffs are indistinguishable from interstate offerings. The courts have noted that once such equipment is provided to the user, the supplier does not have the capacity to restrict its use to intrastate communications:

"Terminal equipment that is connected to a telephone subscriber's station and line does in fact connect with the national telephone network. Usually it is not feasible, as a matter of economics and practicality of operation, to limit the use of such equipment to either interstate or intrastate transmission."⁶³

The federal courts have held that the "intrastate" exemption does not prohibit this Commission from regulating the terms and conditions of carrier-supplied terminal equipment: if [47 U.S.C. § 152(b)(1)] were construed to give the states primary authority over joint terminal equipment, i.e., equipment used interchangeably for interstate and intrastate service, then—whenever state regulations conflicted with federal rules applicable to interstate calls—the FCC would necessarily be prevented from discharging its statutory duty under [47 U.S.C. §§ 151-152 (1976)] to regulate interstate communication.⁶⁴

The "intrastate" exemption only denies this Commission regulatory authority over matters which in their "nature and affect are separable from and do not substantially affect the conduct or development of interstate communications".⁶⁵ Therefore, unlike certain carrier activities, e.g., the provision of local exchange service, monopoly carrier offering of terminal equipment cannot be classified as a wholly intrastate activity.

As the Comments of the Computer and Business Equipment Manufacturers Association (CBEMA) in this proceeding persuasively demonstrate, 47 U.S.C. § 152(b)(4) (1976) does not prevent the Commission from asserting jurisdiction in this proceeding over "connecting carriers" in the same manner that it regulates "fully subject"

⁵⁹ 47 U.S.C. § 221(b)(1976) provides in pertinent part that: nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities or regulations for or in connection with . . . telephone exchange service . . . in any case where such matters are subject to regulation.

⁶⁰ See A.T. & T. Comments at 7.

⁶¹ 552 F.2d at 1045. Other courts have construed this statute in an identical manner. See *Puerto Rico Telephone Co. v. FCC*, 553 F.2d 694 (1st Cir. 1977).

⁶² See, e.g., AT & T Comments at 3-6 and GTE Opposition at 7.

⁶³ *North Carolina Utilities Comm'n v. FCC*, 537 F.2d 787, 791 (4th Cir.), cert. denied, 429 U.S. 1027 (1976). See *Puerto Rico Telephone Co. v. FCC*, 553 F.2d 694 (1st Cir. 1977).

⁶⁴ *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1045 (4th Cir.), cert. denied, 434 U.S. 874 (1977).

⁶⁵ *North Carolina Utility Comm'n*, 537 F.2d at 793. Therefore, even assuming, *arguendo*, that a meaningful distinction between "interstate" and "intrastate" terminal equipment offering could be made, the courts have asserted that the "intrastate" exemption cannot be used to sanction: any state regulation, formally restrictive only of intrastate communication, that in effect encroaches substantially upon the Commission's authority under Section 201 through 205. (*Id.*)

As outlined in Section II, the dangers to the Commission's policies by the *laissez faire* approach of certain proposals regarding the terminal equipment offerings of monopoly carriers without doubt poses such an encroachment.

carriers.⁶⁶ The Communications Act expressly provides that "connecting carriers" are subject to Commission regulation based upon Sections 201-205 of the Act.⁶⁷ As one federal court has asserted:

"[N]ot only telephone companies with lines that extend interstate but also those local companies that provide interstate service solely through connection with the lines of telephone companies that are unrelated to them, are expressly made amendable to the regulatory provisions of sections 201 through 205 of the Act. * * * It is in connection with the Commission's efforts to discharge its responsibilities under sections 201 through 205 and the alleged frustrating effect of countervailing state action that this controversy about jurisdiction * * * has arisen."⁶⁸

Therefore, it is clear that there is no specific statutory exemption limiting the Commission's jurisdiction over the matters raised in the Petition for Declaratory Ruling in this proceeding.

CONCLUSION

IDCMA has clearly demonstrated that there is a need for Commission action on the matters raised in the Petition for Declaratory Ruling and that the Commission has authority to assert jurisdiction over these issues. The important federal interests which may be affected by the manner in which monopoly carriers offer terminal equipment and the pressing need for a uniform regulatory scheme mandate the Commission's pre-emptive assertion of jurisdiction.

The invocation of jurisdiction by the Commission does not preclude consideration of the legitimate interests of the state regulatory agencies in the matters raised in the Petition for a Declaratory Ruling. Section 410(c) of the Communications Act provides the Commission with authority to refer any matter "relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board."⁶⁹ This statute provides a mechanism: under which national primacy is recognized, yet the Commission is authorized to receive and consider information, views and proposals from concerned state agencies that may aid it in reaching informed and wise decisions.⁷⁰

It is clearly in the public interest for the Commission to convene a Joint Board in this proceeding. A Joint Board would be able to fully evaluate the remedies which should be applied, if any, in light of the serious allegations of abuse by monopoly carriers in the terminal equipment field. The petitioners in this proceeding have requested that monopoly carriers only be allowed to offer terminal equipment through the vehicle of a totally separate arm's length subsidiary.⁷¹ In view of the serious potential for cross-subsidization posed by the provision of competitive terminal equipment by monopoly carriers, this form of relief appears to be justified.

Certain telephone carriers have expressed concern that petitioners' second requested form of relief, i.e., to restrict sales by a carrier's wholly separated terminal equipment entity to areas outside the parent carrier's general telephone exchange, may be overly burdensome, particularly to those small carriers operating in rural areas. Indeed, the comments of several participants allege that small telephone companies, including a carrier which has allegedly sold only 20 telephones,⁷² will be adversely affected by the remedies proposed to the extent that various items of terminal equipment and maintenance may no longer be available in certain rural areas.⁷³ While IDCMA cannot attest to the veracity of these allegations, it is uncertain whether small rural telephone companies present the same extent or degree of problems inherent in terminal equipment sales activities of large monopoly carriers, such as AT&T and GTE. IDCMA, however, is aware that whatever action the Commission may take as a result of this proceeding is likely to affect all carriers, including small carriers as well as large telephone companies such as AT&T, GTE or Continental. Therefore, IDCMA suggests that the Commission may want to

⁶⁶ CBEMA Comments at 5-6.

⁶⁷ 47 U.S.C. § 152(b) (1976).

⁶⁸ *North Carolina Utilities Comm'n*, 537 F.2d at 792. See *GTE Service Corp. v. FCC*, 474 F.2d 724 (2d Cir. 1973). In *GTE Service Corp.*, the Court sustained the Commission's jurisdiction over a connecting carrier, Mankato Citizens Telephone Company, whose facilities were contained within one state.

⁶⁹ 47 U.S.C. § 410(c) (1976). Compare Docket 20981 in which the Commission convened a Joint Board to analyze the potential impact of terminal equipment competition on jurisdictional separations. *Customer Provision of Terminal Equipment*, 63 F.C.C.2d 202 (1976); *Terminal Equipment/Jurisdictional Separations*, 64 F.C.C.2d 733 (1971).

⁷⁰ *North Carolina Utilities Comm'n*, 537 F.2d at 794.

⁷¹ In its Comments, CBEMA has indicated its support for this position.

⁷² See United States Independent Telephone Association (USITA) Comments at 3.

⁷³ National Telephone Cooperative Association (NTCA) Comments in Opposition at 3; See Rochester Telephone Comments at 2.

consider whether a full or partial waiver or an exemption for small unaffiliated telephone carriers would be in the public interest.⁷⁴

This issue could be included as an item of inquiry in any Commission notice of proposed rulemaking which may result from this proceeding. Indeed, in light of the extensive allegations and representations which have been made by all parties, institution of a rulemaking proceeding may in fact be necessary to assure that the relevant facts and issues are fully explored.

Furthermore, if at the conclusion of this rulemaking proceeding a determination is made that carrier sale of terminal equipment is in the public interest, the Joint Board or the Commission should promulgate uniform, nationwide standards to implement its decision. These standards could be developed either in the Joint Board proceeding or in a separate rulemaking. Pending the outcome of these suggested proceedings, IDCMA urges the Commission to prohibit any monopoly carrier subject to Commission jurisdiction⁷⁵ from engaging in the sale of terminal equipment. This action is designed to maintain the *status quo* and to prevent irreparable injury not only to the suppliers of independent terminal equipment but to the competitive marketplace as well. If any carrier believes that it should be exempt from this action on account of the limited nature of its terminal equipment offerings or otherwise, the carrier could request a waiver from the Commission. The burden of proof, however, would be on the carrier to demonstrate specific facts that would justify such a waiver.⁷⁶

Wherefore, for the reasons set forth above, IDCMA respectfully requests that the Commission:

- (1) Issue a declaratory ruling asserting its pre-emptive jurisdiction over issues related to terminal equipment regulation;
- (2) Undertake expeditiously to institute a Joint Board proceeding to consider the complex policy issues raised by monopoly carrier participation in the terminal equipment field; and
- (3) Prevent monopoly carriers subject to federal regulation from engaging in the sale of terminal equipment during the pendency of this Joint Board proceeding or any other proceedings established to consider the issues raised in the Petition for Declaratory Ruling.

Respectfully submitted.

HERBERT E. MARKS.
STEPHEN R. BELL.

April 4, 1979.

Senator HOLLINGS. Very good. Thank you, Mr. Carr.

Mr. Beach.

Mr. BEACH. Mr. Chairman, my name is Stephen H. Beach and I am a member of the board of directors of the Association of Data Processing Service Organizations, Inc., more commonly known in the computer services industry as ADAPSO. I am also vice president of Control Data Corp. of Minneapolis, Minn., and I am presently assigned as general counsel of the Data Services Group which is headquartered in Greenwich, Conn. I am going to depart from my prepared statement in the interest of brevity, and I request that it be included in the record of these proceedings.

On behalf of ADAPSO's membership, I wish to thank the subcommittee for this opportunity to express ADAPSO's views on S. 611, the Communications Act Amendments of 1979, and S. 622, the Telecommunications Competition Deregulation Act of 1979. As an association of both large and small users of telecommunications services, ADAPSO has always had a keen interest in any proposal which would affect the environment in which both domestic and international telecommunications services are made available to users.

⁷⁴ There is precedent for such an exemption in the Commission's Computer Inquiry Rules. See 47 C.F.R. § 64.702(b) (1977).

⁷⁵ As IDCMA noted *supra* at 29-30, the Commission has the authority to regulate "connecting carriers" as well as "fully subject" carriers. See 47 U.S.C. § 152(b)(4) (1976).

⁷⁶ See e.g., *In the Matter of AT&T Revisions of Tariff, FCC No. 260 Private Line Services, Series 5000 (TELEPAK)*, 64 F.C.C. 2d 971, 978 n.14 (1977) (Docket 18128).

Mr. Chairman, we of ADAPSO have reviewed the two bills now under consideration and, frankly, we are gratified by what we see. In ADAPSO's view, both S. 611 and S. 622 take needed action to liberate innovative and competitive telecommunications service offerings from unnecessary Federal regulation.

At the same time, however, these two bills reflect a realistic assessment of the relative power of the participants in today's telecommunications industry, as well as the inevitable pitfalls which would accompany precipitous deregulation. The subcommittee and its staff are to be commended for achieving a balanced approach to meaningful deregulation and the preservation and promotion of effective competition.

In the limited amount of time available to me this afternoon, I would like to touch briefly upon two areas of interest to ADAPSO which are raised by the proposed legislation. The first involves a provision of S. 611 which, in ADAPSO's view, appears to be somewhat out of place in deregulation legislation.

Specifically, I am referring to the proposed new section 102 of the Communications Act which would extend the jurisdiction of the Federal Government over the previously unregulated and vigorously competitive information services industry.

The apparent purpose of this section, at least when read in conjunction with the proposed revisions of section 203, is to preempt regulation by the States. Although ADAPSO recognizes that the only power given to the Commission with respect to information services is to promote competition, regulatory jurisdiction, once obtained, is rarely construed narrowly by an administrative agency; even more rarely is it voluntarily abandoned. Consequently, ADAPSO urges the subcommittee to consider the adoption of a brief statement of Federal preemption, as well as a complete proscription of Commission regulation of information software and services. In this way, the subcommittee will achieve its laudable goals of competition and deregulation without creating an unintended opportunity for increased regulation in an already vigorous, competitive industry.

The second point I wish to discuss this afternoon involves the provisions of section 204, as proposed by S. 611, and its counterpart in S. 622, section 225(d)(2)(A).

These two sections enumerate the criteria which the Commission is directed to use in distinguishing among carriers for purposes of determining the appropriate level of regulation.

In essence, both bills require an evaluation of a variety of competitive criteria which, while admittedly relevant, are difficult to quantify, and are of the type that will engender protracted disputes, will encumber the Commission's administrative processes, and will otherwise complicate the deregulation process contemplated by Congress.

ADAPSO is of the view that more satisfactory results could be achieved by using a more basic standard than the criteria proposed by S. 611 and S. 622. Specifically, ADAPSO suggests that the Commission be directed to focus upon the relationship which exists between a carrier and the basic transmission facilities which it uses to provide service. Carriers which undertake the construction, acquisition, or operation of basic transmission facilities and which,

as a result, exercise absolute control over the access and use of such facilities, should be considered in a much different light than those carriers which do not possess similar power.

In S. 611 parlance, carriers which own or control basic transmission facilities should be considered category II carriers; those carriers which merely lease or enhance leased circuits obtained from other carriers should be considered category I carriers. The use of this criterion as, at least, an initial demarcation point in determining the appropriate level of carrier regulation will clearly facilitate the Commission's processes.

For the foreseeable future, various telecommunications services are unlikely to be subject to effective competition for a variety of reasons.

To begin with, the overwhelming presence of American Telephone and Telegraph Co. in the national market cannot be ignored. In exchange markets, local telephone companies can limit competition through their control over access to the nationwide switched telephone network and over access to the intercity networks of specialized carriers.

Other limitations on competition are imposed by high entry costs, as is the case with satellite and terrestrial microwave systems, and by the scarcity of resources, as is the case where an allocation of the radio spectrum is involved.

In dealing with carriers that own or control basic transmission facilities and that wish to engage in competitive endeavors, maximum separation, that is, the requirement of a fully separated entity, should be the Commission's primary regulatory tool.

The major advantage of maximum separation is that it effectively deals with a number of regulatory problems, such as cross-subsidization and tying, with a minimum amount of agency involvement. In addition, unlike accounting procedures, the requirement of a fully separated entity affirmatively promotes competition by creating a new and distinct corporate profit center.

The use of ownership or control of basic transmission facilities as a criterion in imposing regulation, will not unduly broaden the Commission's jurisdiction. Although the number of carriers included in category II might be somewhat larger than under the present bill, the Commission has the power to vary the quantity and quality of regulation it exercises over category II carriers.

The expansion in size of category II envisioned by ADAPSO, however, will help prevent anticompetitive abuses that might otherwise go unregulated. A consideration of satellite carriers, whose numbers are limited by costs, the availability of orbits, and the availability of radio spectrum, demonstrates this point.

Although these carriers may experience competition among themselves for transmission services, they enjoy special economic power with respect to other potential competitors.

If classified as category I carriers under S. 611, satellite carriers would not be required to provide service to remote access data processors, nor would they be required to interconnect customer-provided equipment. These satellite carriers could, however, offer a bundled data processing/communications/equipment service. The effect would be to preclude data processors from offering any services via satellite facilities.

In addition, the carrier's customers would also be precluded from using their own equipment or that of a remote access data processor for satellite-based services.

In summary, it is ADAPSO's view that the ownership or control of basic transmission facilities should be the line of demarcation between significant and de minimis regulation.

Combined with the Commission's ability to vary regulation pursuant to congressionally articulated standards and the use of maximum separation, the above approach should promote competition and minimize Government regulation.

At the same time, it will provide a flexible tool to meet future changes in technology.

In closing, Mr. Chairman, I wish to reaffirm ADAPSO's support for the procompetition principles embodied in these bills. ADAPSO has offered these brief comments in the interest of assuring that the proposed legislation effectively achieves a flexible regulatory environment in which full and fair competition is fostered.

With the subcommittee's permission, ADAPSO will supplement these remarks with a more detailed statement and analysis of the domestic and international provisions of these bills and suggested statutory language.

Thank you for the opportunity to participate in these hearings.
[The statement follows:]

STATEMENT OF STEPHEN H. BEACH OF THE ASSOCIATION OF DATA PROCESSING
SERVICE ORGANIZATIONS, INC.

Mr. Chairman and Members of the subcommittee, my name is Stephen H. Beach and I am a member of the Board of Directors of the Association of Data Processing Service Organizations, Inc., more commonly known in the computer services industry as ADAPSO. I am also Vice President of Control Data Corporation of Minneapolis, Minnesota and I am presently assigned as General Counsel of the Data Services Group which is headquartered in Greenwich, Connecticut.

On behalf of ADAPSO's membership, I wish to thank the subcommittee for this opportunity to express ADAPSO's views on S. 611, the Communications Act Amendments of 1979, and S. 622, the Telecommunications Competition Deregulation Act of 1979. As an association of both large and small users of telecommunications services, ADAPSO has always had a keen interest in any proposal which would affect the environment in which both domestic and international telecommunications services are made available to users.¹ Mr. Chairman, we of ADAPSO have reviewed the two bills now under consideration and, frankly, we are gratified by what we see. In ADAPSO's view, both S. 611 and S. 622 take needed action to liberate innovative and competitive telecommunications service offerings from unnecessary Federal regulation. At the same time, however, these two bills reflect a realistic assessment of the relative power of the participants in today's telecommunications industry, as well as the inevitable pitfalls which would accompany precipitous deregulation. The subcommittee and its staff are to be commended for achieving a balanced approach to meaningful deregulation and the preservation and promotion of effective competition.

In the limited amount of time available to me this morning, I would like to touch briefly upon three areas of interest to ADAPSO which are raised by the proposed legislation. The first involves ADAPSO's preference for the approach to deregulation taken by S. 611, as compared to the equally valid, but less effective, approach envisioned by S. 622. Although the substantive Title II provisions of both bills are in many ways symmetrical, their ultimate efficacy in achieving deregulation and pro-

¹ ADAPSO is the principal trade association of this country's 2,600 data processing service organizations. By dollar volume, ADAPSO's members represent approximately 48 percent of the entire computer services industry. Its member companies provide the public with a broad range of computer services such as local batch processing, software design and support, and terminal-based network services. Within this latter category are remote access data processing and time sharing services. Again by dollar volume, ADAPSO's members account for 85 percent of the remote processing services performed by the industry.

moting full and fair competition will, in ADAPSO's view, differ significantly because of the distinct manner in which the operative language of each bill is couched.

Whereas S. 622 directs the Federal Communications Commission to prescribe regulations to achieve certain specified objectives, S. 611 itself mandates deregulation by making certain forms of regulation unlawful and it promotes competition by prohibiting certain carrier activities unless accompanied by various structural safeguards. Notwithstanding its more direct and detailed approach, S. 611 maintains regulatory flexibility by empowering the Commission to waive a number of statutory requirements and prohibitions. Such flexibility is essential in any statute which emerges from this Subcommittee, given the dynamic technology which is typical today, and which will certainly be typical of tomorrow's information services and telecommunications industries.

By making legislative decisions as to the appropriateness of various regulatory tools, however, S. 611 will provide both industries with a greater degree of certainty. Such regulatory certainty will redound to the benefit of the public, the information services and telecommunications industries, and the nation. To begin with, the Commission will be able to commence operations more quickly under its newly amended legislative charter with a significant amount of congressional guidance and a substantial body of precedent already in place. In addition, carriers, data processors, and others will be able to plan new service offerings and allocate their resources accordingly, unhindered by the specter of regulatory uncertainty. As a result, the public will benefit from these new offerings at a much earlier date. The United States is the world's leading developer and user of telecommunications based technologies. To create an environment in which new development and innovation become tentative could threaten that leadership position.

The second area of interest to ADAPSO which I will address this morning involves a provision of S. 611 which, in ADAPSO's view, appears to be somewhat out of place in "deregulation" legislation. Specifically, I am referring to the proposed new Section 102 of the Communications Act which would extend the jurisdiction of the Federal Government over the previously unregulated and vigorously competitive information services industry. The apparent purpose of this section, as least when read in conjunction with the proposed revisions of Section 203, is to preempt regulation by the States. Although ADAPSO recognizes that the only power given to the Commission with respect to information services is to promote competition, regulatory jurisdiction, once obtained, is rarely construed narrowly by an administrative agency; even more rarely is it voluntarily abandoned. Consequently, ADAPSO urges the Subcommittee to consider the adoption of a brief statement of Federal preemption, as well as a complete proscription of Commission regulation of information software and services. In this way, the Subcommittee will achieve its laudable goals of competition and deregulation without creating an unintended opportunity for increased regulation in an already vigorous, competitive industry.

The third point I wish to discuss this morning involves the provisions of Section 204, as proposed by S. 611, and its counterpart in S. 622, Section 225(d)(2)(A). These two sections enumerate the criteria which the Commission is directed to use in distinguishing among carriers for purposes of determining the appropriate level of regulation. S. 611 directs the Commission to consider whether a carrier is subject to "effective competition" and whether it offers an essential service that would not be available at reasonable rates if it were subject to competition. S. 622, on the other hand, directs the Commission to look to such factors as the carrier's market share, price leadership, financial resources, customers, and competition. In essence, both bills require an evaluation of a variety of criteria which, while admittedly relevant, are difficult to quantify, and are of the type that will engender protracted disputes, will encumber the Commission's administrative processes, and will otherwise complicate the deregulation process contemplated by Congress.

ADAPSO is of the view that more satisfactory results could be achieved by using a more basic standard than the criteria proposed by S. 611 and S. 622. Specifically, ADAPSO suggests that the Commission be directed to focus upon the relationship which exists between a carrier and the basic transmission facilities which it uses to provide service. Carriers which undertake the construction, acquisition, or operation of basic transmission facilities and which, as a result, exercise absolute control over the access and use of such facilities, should be considered in a much different light than those carriers which do not possess similar power. In S. 611 parlance, carriers which own or control basic transmission facilities should be considered Category II carriers; those carriers which merely lease or enhance leased circuits obtained from other carriers should be considered Category I carriers. The use of this criterion as, at least, an initial demarcation point in determining the appropriate level of carrier regulation will clearly facilitate the Commission's processes.

For the foreseeable future, various telecommunications services are unlikely to be subject to effective competition for a variety of reasons. To begin with, the overwhelming presence of American Telephone and Telegraph Company in the national market cannot be ignored. In exchange markets, local telephone companies can limit competition through their control over access to the nationwide switched telephone network and over access to the intercity networks of specialized carriers. Other limitations on competition are imposed by high entry costs, as is the case with satellite and terrestrial microwave systems, and by the scarcity of resources, as is the case where an allocation of the radio spectrum is involved.

In dealing with carriers that own or control basic transmission facilities and that wish to engage in competitive endeavors, maximum separation, that is, the requirement of a fully separated entity, should be the Commission's primary regulatory tool. The major advantage of maximum separation is that it effectively deals with a number of regulatory problems, such as cross-subsidization and tying, with a minimum amount of agency involvement. In addition, unlike accounting procedures, the requirement of a fully separated entity affirmatively promotes competition by creating a new and distinct corporate profit center.

The use of ownership or control of basic transmission facilities as a criterion in imposing regulation will not unduly broaden the Commission's jurisdiction. Although the number of carriers included in Category II might be somewhat larger than under the present bill, the Commission has the power to vary the quantity and quality of regulation it exercises over Category II carriers. The expansion in size of Category II envisioned by ADAPSO, however, will help prevent anticompetitive abuses that might otherwise go unregulated. A consideration of satellite carriers, whose numbers are limited by costs, the availability of orbits, and the availability of radio spectrum, demonstrates this point. Although these carriers may experience competition among themselves for transmission services, they enjoy special economic power with respect to other potential competitors. If classified as Category I carriers under S. 611, satellite carriers would not be required to provide service to remote access data processors, nor would they be required to interconnect customer-provided equipment. These satellite carriers could, however, offer a bundled data processing/communications/equipment service. The effect would be to preclude data processors from offering any services via satellite facilities. In addition, the carrier's customers would also be precluded from using their own equipment or that of a remote access data processor for satellite-based services.

In summary, it is ADAPSO's view that the ownership or control of basic transmission facilities should be the line of demarcation between significant and de minimis regulation. Combined with the Commission's ability to vary regulation pursuant to congressionally articulated standards and the use of maximum separation, the above approach should promote competition and minimize government regulation. At the same time, it will provide a flexible tool to meet future changes in technology.

In closing, Mr. Chairman, I wish to reaffirm ADAPSO's support for the pro-competition principles embodied in these bills. ADAPSO has offered these brief comments in the interest of assuring that the proposed legislation effectively achieves a flexible regulatory environment in which full and fair competition is fostered. With the Subcommittee's permission, ADAPSO will supplement these remarks with a more detailed statement and analysis of the domestic and international provisions of these bills.

Thank you for the opportunity to participate in these hearings.

[The following information was subsequently received for the record:]

WILKINSON, CRAGUN & BARKER,
Washington, D.C., May 31, 1979.

Re S. 611—The Communications Act Amendments of 1979; S. 622—The Telecommunications Competition Deregulation Act of 1979.

Hon. ERNEST F. HOLLINGS,
Chairman, Subcommittee on Communications,
Russell Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: On May 3, 1979, Mr. Stephen H. Beach of the Association of Data Processing Service Organizations, Inc. (ADAPSO) testified before your Subcommittee with respect to S. 611, the Communications Act Amendments of 1979, and S. 622, the Telecommunications Competition Deregulation Act of 1979. Enclosed for inclusion in the record of these hearings is a supplemental statement which further elaborates ADAPSO's views. As requested by your Subcommittee staff, we are forwarding ten copies of ADAPSO's supplemental statement.

If you should have any questions concerning the enclosed material, please do not hesitate to contact us.

Sincerely,

HERBERT E. MARKS.
JOSEPH P. MARKOSKI.

Enclosures.

SUPPLEMENTAL STATEMENT OF THE ASSOCIATION OF DATA PROCESSING SERVICE ORGANIZATIONS, INC.

On May 3, 1979, Mr. Stephen H. Beach, a member of the Board of Directors of the Association of Data Processing Service Organizations, Inc. (ADAPSO), appeared before this Subcommittee and outlined ADAPSO's views on S. 611, the Communications Act Amendments of 1979, and S. 622, the Telecommunications Competition Deregulation Act of 1979. The following statement is submitted as a supplement to Mr. Beach's formal remarks and ADAPSO requests that it be included as part of the record of these proceedings.

ADAPSO is the principal trade association of this country's 2,600 data processing service organizations. By dollar volume, ADAPSO's members represent approximately 48 percent of the entire computer services industry. Its member companies provide the public with a broad range of computer services such as local batch processing, software design and support, and terminal-based network services. Within this latter category are remote access data processing and time sharing services. Again by dollar volume, ADAPSO's members account for 85 percent of the remote processing services performed by the industry.

Simply defined, remote access data processing enables a subscriber to access and make use of a computer that is physically distant from the subscriber's premises. Time sharing services permit multiple subscribers to use a physically distant computer at approximately the same time. In both situations, the connection between the subscriber and the computer is usually accomplished through the use of telephone or telegraph grade lines and satellite circuits, which are obtained from communications common carriers.¹

A. THE COMPUTER SERVICES INDUSTRY

Because remote access computer services are dependent upon the availability of high quality and reasonably priced common carrier communications services, a unique relationship has developed between the data processing and telecommunications industries. This relationship has stimulated developments and improvements in computer communications equipment and in common carrier services which otherwise might not have evolved. In responding to competition, data processors have attempted to reduce their communications costs and thus their prices by making the most efficient possible use of their telecommunications facilities. As a result of these cost-saving efforts, many technological improvements in data communications equipment, software, and techniques have taken place which improve both the speed and quality of data transmission.

These innovations have been brought about by a highly competitive industry that is composed of many independent companies, both large and small. The varied sizes of the industry's participants and the competitive atmosphere in which they operate have contributed to an environment in which the unique or unusual data processing needs of a few, as well as the more commonplace requirements of the many, have all been amply satisfied. Whether the need be for international access to a poison antidote library or for the local batch processing of a payroll, the data processing requirements of the American public have been met efficiently, reliably, and at low cost.²

The universal availability of sophisticated data processing services is not the result of a government conferred monopoly. Rather, it is a function of the unfettered operation of the free enterprise system. This system has been nurtured by the Federal Communications Commission, which has kept the monopoly power of communications common carriers within proper bounds and has fostered the development of an increasing variety of low cost communications services. Because of these Commission policies, success in the computer services industry has not been depend-

¹ With the advent of these services, it has become possible for literally anyone in the world with access to a telephone to enjoy the benefits of data processing.

² Even a quick review of two non-exhaustive compilations of data processing equipment and service vendors reveals that there are virtually no areas of the country in which data processing is further than a local or toll-free phone call away. See Datapro Research Corporation, *EDP Buyer's Bible* 70H-100-105 (July 1978); Datapro Research Corporation; *Data Communications* C91-010-105 (July 1978).

ent upon either immense resources or control over essential communications facilities. Rather, innovation, efficiency, and service to the consuming public remain the keys to prosperity. It is the pursuit of these goals which has accelerated both the evolution of computer systems and their growing importance in the daily lives of an increasing number of Americans.

It is ADAPSO's firm conviction that the American public, American technology, and the nation's economy have all benefited from competition in the computer services and telecommunications industries. It is for this reason that ADAPSO fully endorses the provisions of S. 611 and S. 622 which rely on marketplace forces and which foster a flexible regulatory environment in which competition is encouraged. Although the underlying philosophy of both bills is equally sound, ADAPSO views S. 611 as the preferable vehicle for achieving a relaxation of federal regulation.³ In view of this fact, ADAPSO has focused its attention on S. 611. Therefore, the following comments pertain largely to the provisions of S. 611, although reference will be made to S. 622 where similar provisions are found in both bills.

B. THE SCOPE OF REGULATORY JURISDICTION

One aspect of S. 611 which is of particular concern to ADAPSO is the proposed new Section 102 of the Communications Act. This section enumerates the findings of Congress with respect to the difficulties encountered in distinguishing between interstate and intrastate telecommunications. It also defines the jurisdiction of the Federal Communications Commission. Among other things, Section 102 authorizes the Commission to exercise jurisdiction over "all commerce in . . . information software, and information services." The apparent purpose of this provision, at least when read in conjunction with the proposed revisions of Section 203, is to preempt regulation of such services by the States.⁴ Although ADAPSO recognizes that Section 203 prohibits the Commission from imposing any requirements on the information software or information services industry other than those needed "to foster competition," ADAPSO is concerned that the regulatory authority contained in Sections 102(a) and 203(d) may be broadly construed by both the Commission and the courts.

In order to avoid an unintended and unwarranted extension of federal regulation, ADAPSO urges the Subcommittee to consider an alternative statutory approach.⁵ Specifically, ADAPSO recommends that the Subcommittee incorporate a simple statement of federal preemption in Section 102 and that it delete the Section's expansive expression of jurisdiction.⁶ With respect to Section 203(d), ADAPSO recommends that the Commission's authority to prescribe rules related to the interconnection of customer-provided equipment be more clearly circumscribed. ADAPSO proposes that it be made clear that Section 203(d) is not intended to provide the Commission with a basis for exercising jurisdiction over the computer services industry.

A related problem is raised by Section 203(g), which could be construed to classify as carriers suppliers of certain types of information services, such as time sharing and remote access data processing services, despite other provisions of the bill. The definition of "information services" in Section 103(15), for example, is clearly broad enough to encompass remote computing services. Similarly, the definition of "telecommunications carrier" in Section 103(5) appears to have been specifically drawn so as to exclude organizations that are engaged in the provisions of such information services. Section 203(a) echoes these definitions by expressly excluding the provisions of information services from the concept of telecommunications service. The apparent purpose of Section 203(g) is to clarify the status of so-called hybrid services (both communications and data processing). It is also apparently intended to recognize the special problems presented by a Category II carrier such as American Telephone and Telegraph Company that also offers services through a separate entity.

³ The reasons for ADAPSO's preference for S. 611 were articulated in the prepared statement submitted to the Subcommittee when Mr. Stephen Beach testified on behalf of ADAPSO on May 3, 1979.

⁴ This has recently been confirmed by the Chairman of the Subcommittee, Senator Hollings. Address by Senator Ernest F. Hollings, ADAPSO 50th Management Conference (May 16, 1979).

⁵ Specific statutory language reflecting ADAPSO's proposals appears in Appendix I to the statement.

⁶ A similar approach was successfully followed by the Congress when it adopted Public Law No. 95-504, the Airline Deregulation Act of 1978. See 49 U.S.C. § 1305(a)(1) (1970). This provision has already been enforced by the courts. See *Hughes Air West v. California Public Utilities Commission*, No. 78-2880-SW (N.D. Cal. March 9, 1979). In a similar vein, ADAPSO recommends that the assertion of jurisdiction over electronics equipment also be qualified.

Under present law, a computer services company that offers remote access data processing is not a common carrier and is therefore not regulated. This should not be changed. Under S. 611, if such a data processing company were to offer a communications service, it would be a Category I carrier, but would be subject to virtually no regulation. A similar result would follow under ADAPSO's proposed classification scheme, which is discussed below. If such a data processing company were affiliated with a Category II carrier, however, the Commission would have broad power under Section 205(b) of S. 611 to prescribe specific structural conditions to prevent any anticompetitive abuses. This would also extend to hybrid services. Similarly, under the ADAPSO recommendation, discussed later, specific provision is made for the problems associated with a dual (communications—data processing) offering by an affiliate of a carrier that offers basic transmission services.

Therefore, the problems with which Section 203(g) is concerned appear to be dealt with elsewhere. By eliminating Section 203(g), however, a number of ambiguities will be avoided. If eliminated, no basis will exist for asserting jurisdiction over remote access data processing service vendors (even as Category I carriers) simply because they offer services that have an "integral" and incidental communications component—even though the primary or even the sole purpose of such service is to provide data processing services directly to the consumer. Therefore, in ADAPSO's view, Section 203(g) should be deleted.

C. THE CLASSIFICATION OF CARRIERS

Section 204, as proposed by S. 611, directs the Federal Communications Commission to classify and regulate all carriers subject to its jurisdiction as either Category I or Category II carriers. Under this proposed classification scheme, Category II carriers are subject to substantially more regulation than Category I carriers. Section 225(d)(2)(A) of S. 622 is similar to its counterpart in S. 611 in that it directs the Commission to prescribe regulations which classify common carriers according to the degree of regulation necessary for each carrier.

In classifying carriers, the Commission is directed by S. 611 to consider whether a carrier is subject to "effective competition" and whether it offers an essential service that would not be generally available at reasonable rates if it were subject to competition. S. 622, on the other hand, directs the Commission to look to such factors as the carrier's market share, price leadership, financial resources, customers, and competition. In essence, both bills require an evaluation of a variety of criteria which appear to be designed to determine the relative economic power of all participants in a particular market, the ability of that market to sustain competition, and the effect which competition and a lessening of regulation will have on the availability of, and rates charged for, essential telecommunications services. In ADAPSO's view, a consideration of the criteria enumerated by S. 611 and S. 622 will require the Commission to apply a number of abstract concepts, the proper application of which in any given situation will be a matter of dispute among reasonable, let alone, interested parties. One such concept which undoubtedly will be the subject of endless disputes is the definition of the appropriate market in which the Commission should conduct its requisite competitive analysis. That disputes will arise is certain, because, at least with respect to S. 611, significant differences in regulatory treatment will result from a carrier's classification.

Although ADAPSO is in basic agreement with the concept of both bills that different classes of carriers warrant different levels of regulation, the classification schemes envisioned by S. 611 and S. 622 will prove to be unnecessarily cumbersome and time consuming in achieving their desired goals. In ADAPSO's view, more satisfactory results could be achieved by using a more basic standard than the criteria proposed by these two bills. Specifically, ADAPSO recommends that all significant regulatory decisions be guided by whether the carriers involved own or control the basic transmission facilities which they, as carriers, offer for hire.⁷ The use of such a standard is appropriate because it takes into account the significant economic power which certain carriers enjoy by virtue of their control over access to essential transmission facilities. This power, which is in many respects unrelated to a carrier's size or business acumen, is strictly a function of a carrier's ownership or control of limited, though essential, telecommunications resources. Because of this power, these carriers have the ability to thwart competition and stifle innovation in

⁷ As used herein, basic transmission facilities mean the lines which constitute the underlying pathway for transmission. They do not include lines or circuits created solely by subdividing or enhancing the quality of an existing line, where the carrier subdividing or enhancing the line obtains it under tariff from another carrier. Similarly, they do not include the switches which may be employed by data processors and others in connection with the use of leased transmission facilities.

the computer services industry and other competitive fields. Those carriers which do not own or control such facilities, but merely lease them under tariff from other carriers, do not possess similar power.

American Telephone and Telegraph Company (AT&T) is, obviously, the country's largest carrier and it owns and controls the vast majority of this nation's telecommunications facilities. Its dominance in the marketplace and control over the nationwide network cannot be ignored. The same is true of the Bell operating companies. Even independent and smaller carriers, however, enjoy similar power, albeit in a limited geographic area. In every local exchange, the local facility-owning telephone company is almost always the sole supplier of service and, as such, can limit competition through its control over access to the nationwide switched telephone network and over access to the intercity networks of specialized carriers. Considerations related to the ownership or control of facilities also place limits on competition. High entry costs, for example, such as those associated with satellite and terrestrial microwave systems, limit the number of participants in a given market. Equally important for its effect on competition is the role played by scarce resources, such as is the case where an allocation of the radio spectrum is involved.

The power of carriers that own or control facilities to refuse interconnection to users, to discriminatorily vary the parameters of service offerings, and to otherwise manipulate or restrict network access should not be underestimated. Carriers which merely lease their facilities under tariff simply cannot exercise the same power over users, since their subscribers can obtain service directly from the underlying carrier. If the underlying carrier, however, refuses service or requires (ties) the use of one service in order to obtain another, the subscriber or resale carrier has no economically viable choice but to comply with the underlying carrier's conditions if service is to be obtained in a timely manner. In view of the power which carriers that own or control basic transmission facilities can wield, it is ADAPSO's view that the line of demarcation between significant and de minimis regulation should depend upon the carrier's relationship to the facilities it uses to provide service.

ADAPSO therefore urges the Subcommittee to consider a classification scheme different from that appearing in Section 204 of S. 611 or Section 225(d) of S. 622. Specifically, ADAPSO recommends that carriers that undertake the construction, acquisition, extension or operation of basic transmission facilities be classified and regulated differently (and potentially more extensively) than carriers which do not undertake such activities. In other words, carriers that own or control basic transmission facilities should be considered Category II carriers and all other carriers should be considered Category I carriers. This classification scheme will not unduly broaden the scope of regulation. Although the number of Category II carriers would admittedly be larger than under the present provisions of S. 611, the Commission should have the power to vary the quantity and quality of regulation it exercises over these carriers. More importantly, the increase in the number of carriers subject to greater regulation will be offset by the ability of the Commission to prevent anticompetitive abuses that might otherwise be beyond the scope of its regulatory powers.

A consideration of satellite carriers, whose numbers are limited by costs, the availability of orbits, and the availability of radio spectrum, demonstrates this point. Although these carriers may experience competition among themselves for transmission services, they enjoy special economic power with respect to other potential competitors. If classified as Category I carriers under S. 611, satellite carriers would not be required to provide service to remote access data processors, nor would they be required to interconnect customer-provided equipment. The effect would be to preclude data processors from offering any services via satellite facilities. In addition, the carrier's customers would also be precluded from using their own equipment or that of a remote access data processor for satellite-based services. These satellite carriers, however, could offer a bundled data processing/communications/equipment service. In order to avoid such a regulatory "loophole," ADAPSO recommends that the classified scheme described above be incorporated in S. 611 in lieu of the present provisions of Section 204.*

D. THE USE OF FULLY SEPARATED ENTITIES

As noted by Chairman Hollings during a recent address, the separate entity requirement of S. 611 is the centerpiece of the proposed legislation now before the Subcommittee. This concept, which is given substance by such provisions as Sections 103(11) and 203(b), is fully supported by ADAPSO. Indeed, ADAPSO is of the view that these so-called maximum separation provisions should be strengthened.

* A specific statutory proposal reflecting this classification scheme appears in Appendix I to this statement.

During the recent hearings which were conducted by the Subcommittee, a number of parties objected to the separate entity provisions of S. 611 as unnecessary and as unduly burdensome. In the view of these parties, traditional common carrier regulatory tools such as ratemaking and accounting procedures provide the Commission with sufficient means to monitor and control the activities of common carriers in competitive markets. ADAPSO has reviewed these arguments and has concluded, as the Subcommittee did originally, that when carriers such as AT&T enter competitive markets, only a structural remedy will protect the interests of monopoly ratepayers, promote competition, and foster innovation. In other words, it remains ADAPSO's position that, as a general principle, carriers that own or control basic transmission facilities should be permitted to engage in commercial data processing and other competitive services only through the vehicle of a separate arm's-length corporate affiliate.

The use of such a structural remedy is, in ADAPSO's view, required by the evils which are sought to be prevented. The opponents of maximum separation and, all too often, many of its supporters generally focus on only the most obvious of anticompetitive abuses—the cross-subsidization of a carrier's competitive service offerings with the revenues of noncompetitive communications services. Consequently, a great deal of attention is also focused upon the relative ability or inability of accounting systems to identify and prevent cross-subsidies.

There are, however, other anticompetitive abuses with which the Subcommittee should be equally, if not more, concerned. Tying arrangements are one such abuse. If facility-owning carriers were permitted to offer both competitive and noncompetitive services directly to the public, these carriers could require their customers to purchase competitive services as a condition precedent to securing basic noncompetitive service. In other words, they could use the demand or absolute need for their noncompetitive services to enhance the desirability of their competitive offerings. This type of abuse can take many subtle forms. A customer, for example, could be led to expect more prompt installation of new circuits, or better repair service for these circuits, if the customer also purchased its competitive services from the carrier. Basic telecommunications services could also be deliberately structured in a manner—unrelated to technical performance—which makes it uneconomical, inefficient, or simply more bothersome to utilize any service other than a carrier's competitive offerings. These anticompetitive results could easily be achieved by carriers through such devices as selectively tailoring network protocols or establishing restrictive interface standards.

The prior Bell System requirement of a Data Access Arrangement (DAA) is a clear example of the type of action which can be taken by carriers to discriminate against competitive offerings. Subsequent to the *Carterfone* decision, the Bell System required the interposition of a telephone company provided piece of equipment, the DAA, between the network and all competitive—but not Bell—data equipment. Although the alleged purpose of the DAA was to protect the network from harm, the net effect of this requirement was to increase the costs and thus reduce the desirability of competitive equipment. It was in recognition of the anticompetitive nature of the DAA requirement that the Federal Communications Commission adopted its present interconnection policies and initiated a registration program for all equipment connected to the telephone network.

Requiring carriers to provide competitive services through a separate corporate affiliate will limit the possibility of the above abuses, but only if the affiliate is "fully separated" from the carrier on a practical daily operating basis. By requiring the corporate affiliate to operate as a distinct business enterprise with separate personnel, separate facilities, and separate books of account, it would be difficult for the carrier to cross-subsidize or engage in the more subtle forms of unfair competition. Outright transfers of funds would be monitored through the regulation of the carrier's rate base in ratemaking proceedings. Tying arrangements and other anticompetitive practices would be discouraged, because, in order to succeed, the affiliate's offerings would have to be structured to meet its own competition and not merely the overriding commercial objectives of its affiliated carrier.

The maximum separation of carrier and affiliate would also have a beneficial impact on competition. By divorcing competitive and noncompetitive service offerings, maximum separation would create two distinct profit centers. The affiliate would seek to maximize its profits through innovation and efficiency in the competitive arena; the carrier would do the same in the noncompetitive telecommunications field. This division of the profit motivation can only inure to the public's benefit. In the past, for example, many of the developments in the computer services industry were spawned by the structural tension caused by the interface between computer services and telecommunications. As noted above, data processors, in their efforts to reduce costs and compete effectively, have generated many technological improve-

ments in data communications equipment, software, and techniques which improve both the speed and quality of data transmission. Carriers which own or control their transmission facilities, on the other hand, simply do not have the same economic incentive to improve the efficiency or accuracy of their data transmission.

The separate entity provisions of S. 611 do not obviate the need for reliable accounting procedures. Standing alone, however, such procedures do not share the utility of maximum separation. To begin with, accounting procedures cannot and do not affirmatively promote competition. Equally important is the fact that such procedures are incapable of addressing, much less limiting, any anticompetitive abuses unrelated to the proper allocation of funds, such as those concerning access to, or the quality of, telecommunications facilities. In addition, it is questionable whether accounting procedures alone, however, rigorous, can prevent cross-subsidization.

Even the best accounting system is limited by the quality of the data which it reflects. When dealing with an organization of the size and with the complex corporate structure of AT&T, the identification and proper attribution of expenses on a cost-causative basis is difficult. Because of its size and organization, AT&T can "bury" expenses by spreading them across a very large number of product lines, both competitive and noncompetitive. It can also "bury" expenses by distributing activities among its various units: Bell Telephone Laboratories, Western Electric Company, Long Lines, the general departments, the Bell operating companies, or among any combination of the above. Consequently, it would be difficult for any accounting system to identify, much less prevent, intra- and inter-corporate subsidization within the Bell System.

Another difficulty with which accounting procedures cannot contend is the historical monopoly position of AT&T. Because of its government conferred franchise, AT&T has over the years amassed tremendous physical resources. These valuable assets have virtually all been acquired at the expense of monopoly ratepayers. If these assets were to be used for competitive service offerings, it would be virtually impossible to attribute all of their associated historical costs in any reasonable fashion to the competitive services. The result would be to confer an unfair and unjustifiable competitive advantage upon the carrier.

The major advantage of maximum separation, however, is that it effectively deals with a large number of regulatory problems with a minimum amount of agency involvement. This, in and of itself, makes the use of fully separated entities a desirable regulatory tool. By requiring the use of separate subsidiaries, S. 611 would ease the task of the FCC and enable it to act simply as a "border guard" between noncompetitive telecommunications services and competitive markets.

The parameters of maximum separation in S. 611 are established by Section 103(11), which defines the terms "fully separated entity" and "fully separated carrier." In large part, these definitions reflect the maximum separation provisions of the FCC's Computer Rules.⁹ Specifically, Section 103(11) provides that in order for two affiliated entities to be "fully separated," they must have separated directors, officers, employees, financial structure, and facilities. In addition, they must deal with one another on an arm's-length basis in the same fashion as they would deal with unaffiliated entities. Although ADAPSO is in basic agreement with the view of maximum separation embodied in this section, certain amplifications are in order.

As drafted, the maximum separation envisioned by Section 103(11) does not take into account all of the forms of cross-subsidization and anticompetitive abuses such as tying in which affiliates can engage when they are not "fully separated." Joint marketing, sales, and promotional efforts, for example, provide many of the same opportunities for cross-subsidization as do the common use of facilities and personnel. The same dangers are presented when a carrier engages in the sale or promotion of data processing or other competitive offering on behalf of its affiliates.¹⁰ In addition to cross-subsidies, the carrier could also unfairly share its knowledge of the identity of the customers of its affiliate's competitors—information which the carrier gains solely by virtue of its role as sole supplier of local service.

To avoid these competitive problems, carriers and entities that are maximally separated should be prohibited from engaging in any joint undertakings. Similarly, a fully separated carrier or entity should be prohibited from selling or promoting the goods or services of its affiliates. In addition, as the Federal Communications Commission recognized when it first articulated the maximum separation requirement, there is implicit in a prohibition of joint undertakings a similar prohibition against the common use by two affiliates of the same corporate name and promo-

⁹ 47 C.F.R. § 64.702(b)-(d) (1978); See *GTE Service Corporation v. FCC*, 474 F.2d 724 (2d Cir. 1973).

¹⁰ *Computer Use of Communications Facilities*, 28 F.C.C. 2d 267, 272 (1971).

tional symbols.¹¹ Without such a requirement, affiliates could assist each other's sales efforts and effectively engage in joint advertising, marketing, and promotional activities by highlighting their common name and promotional logo. Consequently, Section 103(11) should also be amended to proscribe the common use of names or symbols by fully separated entities and carriers.

Although Section 103(11) requires maximally separated entities to deal with each on an arm's-length basis under the same terms and conditions as they deal with unaffiliated organizations, ADAPSO suggests that this concept be further refined by requiring fully separated carriers and entities to secure their transmission services from their carrier affiliates pursuant to tariffs of general applicability. Such a requirement is essential if there is to be any meaningful protection against cross-subsidization and other unfair competitive practices. If affiliates were permitted to deal with each other pursuant to contracts, telecommunications services could be configured in such a way that they would only be of use to the affiliate. Although such service offerings might ostensibly be available to all other users, the intentional manipulation of technical or other specifications of the service could render such availability an empty protection against "sweetheart" contracts. If such a service were reconfigured to meet a service request of an unaffiliated organization, price could easily be manipulated to aid affiliated entities or carriers at the expense of unaffiliated competitors.¹²

As noted above, ADAPSO is of the view that, as a general principle, maximum separation should apply whenever a facility-owning carrier wishes to engage in a competitive endeavor. ADAPSO also recognizes, however, as does Section 203(b), that there will arise situations where strict application of this principle would cause undue hardship and might adversely affect the availability of service. In such cases, the Commission should be permitted to modify, after notice and hearing, the requirement of a separate affiliate. In exercising this discretion, the Commission should be directed by Congress to waive only those requirements of maximum separation as are necessary to assure the availability of service to the public. In addition or in the alternative, the Commission should be permitted to impose other conditions that might, in a given case, adequately protect competition without maximum separation.¹³

When a facility-owning carrier does use a separated carrier to offer a competitive service, the question arises whether that separated carrier should be required to offer non-communications services through a separate affiliate. With certain basic transmission carriers, such as AT&T, there are clearly special problems that require special treatment. For example, AT&T might offer a broadly based communications service which is, to some extent, competitive. It could bundle (that is, not offer separately) data processing within that service with no separate charge. This would have a very detrimental effect on competition in the provision of computer services. Similarly, the habit of vertical and horizontal integration bred into the Bell System will not disappear overnight.

This and related problems can be handled either of two ways. First, a competitive service carrier affiliated with a basic transmission carrier could be required by statute to offer non-communications services through a separate affiliate, unless the Commission determined that it was appropriate to relax the restriction in whole or in part. Alternatively, maximum separation need not be automatically required. Rather, the Commission could be authorized to prescribe separation or other conditions to achieve the goals of increasing competition and eliminating anticompetitive practices. These conditions could be imposed for varying amounts of time. Thus, such a provision could be used as a transition mechanism and to handle the special problems posed by the Bell System's size, its historic monopoly franchise, and its past attempts to limit competition.¹⁴

E. THE 1956 CONSENT DECREE

The newly proposed Section 229 of the Communications Act is intended to override certain provisions of the antitrust Consent Decree agreed to by AT&T and the United States Department of Justice in 1956.¹⁵ ADAPSO questions whether legislation is an appropriate vehicle with which to modify such a judicially approved decree. In addition, ADAPSO is concerned that such legislative action may have an

¹¹ *Id.*

¹² Specific statutory language incorporating ADAPSO's suggestions with respect to Section 103(11) appears in Appendix I to this statement.

¹³ Appropriate statutory language incorporating ADAPSO's maximum separation proposal appears in Appendix I to this statement.

¹⁴ This alternative amendment appears in Appendix I to this statement.

¹⁵ See *United States v. Western Electric Co.*, 13 P&F Rad. Reg. 2143 (D.N.J. 1956).

unjustified adverse effect on the pending litigation now being prosecuted against AT&T by the Justice Department.

If Congress ultimately does decide to modify this decree, however, it is essential that the provisions of S. 611 which mandate the use of fully separated entities whenever AT&T wishes to engage in competitive or "resale" type enterprises be retained. It would be most unwise to liberate AT&T from the constraints of the 1956 Consent Decree without taking prophylactic measures to assure that AT&T's newly permitted entry into competitive arenas does not adversely affect competition or stifle innovation. In ADAPSO's view, requiring AT&T to use a maximally separated entity whenever it enters such fields is a non-punitive and potentially beneficial way of ameliorating an otherwise severe competitive danger.

F. INTERCONNECTION AND SERVICE

As noted previously, communications common carriers that own or control basic transmission facilities possess special market power. Such carriers need not be enormous corporations, nor must they enjoy a vast geographic monopoly in order to exercise this power. Rather, it is the ability of these carriers to control access to the nationwide switched network and to the networks of the specialized carriers that gives them the unique power to engage in anticompetitive practices. These carriers can, for example, wreak tremendous competitive havoc simply by refusing to provide service or refusing to interconnect with the networks of competitive carriers, with the private telecommunications systems of remote access data processors, or with customer-provided terminal equipment.

Although Section 208(b), as proposed by S. 611, requires Category II carriers to provide interexchange service upon reasonable request and Section 207(a) requires certain telecommunications carriers to interconnect with others, these provisions are seriously inadequate. Under these provisions, Category I carriers, such as satellite carriers, need not provide service upon request nor interconnect with customer-provided equipment. In addition, there is no explicit requirement that interconnection be provided for the private networks of remote access data processors. To remedy these deficiencies, ADAPSO recommends that Sections 207 and 208 be amended so as to require all carriers to provide service and interconnection whenever a reasonable request is made.¹⁶

G. FLEXIBILITY IN REGULATION

The key to an effective regulatory environment in which competition and innovation can flourish, whether based on the classification scheme embodied in S. 611 or as suggested above, is regulatory flexibility. Rather than proscribing almost any regulation of Category I carriers and imposing certain basic duties only on Category II carriers, a preferable approach would be to empower the Federal Communications Commission to impose or relax various regulatory requirements pursuant to congressionally articulated standards upon given findings of fact. Regulatory flexibility is essential if the dynamic technology which is so typical of today is to continue to characterize the telecommunications and computer services industries of the future. The simple fact is that Congress cannot make blanket decisions concerning the appropriate level or nature of regulation for tomorrow's technology without creating a risk that such regulation or lack thereof will endanger the evolution of that technology. To a limited extent, the amendments of Sections 202 and 203 proposed by S. 611 recognize this risk.

Because, as noted above, different classes of carriers enjoy varying degrees of economic and market power, the Commission's ability to vary the regulation it exercises should be circumscribed, depending on the class of carrier with which it deals. As concerns those carriers which own or control basic transmission facilities, ADAPSO's proposed Category II carriers, the Commission should be authorized to forbear regulation, after notice and opportunity for hearing, where the carrier or class of carriers involved affirmatively demonstrates that regulatory forbearance will serve the purposes intended by Congress. The burden of proof for increased forbearance should appropriately rest on the carriers themselves in light of the power which they possess, by virtue of their ownership of basic transmission facilities, to engage in anticompetitive conduct. The Commission's powers should be more limited with respect to those carriers which are unaffiliated with facility-owning carriers and which merely lease their transmission facilities, ADAPSO's proposed Category I carriers. These carriers should not, as a general rule, be regulated by the Commission unless, after notice and opportunity for hearing, the Commission itself

¹⁶ Specific statutory language which would implement ADAPSO's suggestion appears in Appendix I to this statement.

affirmatively adduces facts or circumstances which demonstrate the need to regulate such carriers to achieve the purposes set forth by Congress. Extensive regulation is clearly unwarranted for such carriers, since their power to engage in anti-competitive conduct is much less than that of underlying carriers.

By combining ADAPSO's proposed classification scheme and the use of regulatory forbearance discussed above, the Congress will assure that anticompetitive abuses are minimized and that basic universal telecommunications service remains available for all those who desire it. The Subcommittee will also achieve its desired goal of eliminating regulation where marketplace forces render government involvement unnecessary. While doing so, innovation and technological growth will continue unimpeded by both government regulation and the abuse of economic power.¹⁷

H. INTERNATIONAL TELECOMMUNICATIONS

In recent years, both ADAPSO and representatives of its member companies have become increasingly active in international telecommunications matters. ADAPSO has actively participated, for example, in the State Department's Public Advisory Subcommittee on Transborder Data Flows, which has been advising United States representatives to the Organization for Economic Cooperation and Development (OECD) with respect to the OECD's proposed guidelines on personal privacy and transborder data flow. Similarly, representatives of ADAPSO's member companies have been actively involved with the United States delegation to the International Telegraph and Telephone Consultative Committee (CCITT). In addition, ADAPSO has become involved in a number of proceedings before the Federal Communications Commission in order to protest the erection of non-tariff trade barriers by foreign telecommunications administrations and to protest the discriminatory treatment accorded American telecommunications users abroad.

These individual and collective experiences lead ADAPSO to make the following recommendations with respect to the international telecommunications provisions of S. 611. To begin with, ADAPSO applauds the Subcommittee for not engaging in pell-mell deregulation of international telecommunications services, merely because many domestic services are being freed from government regulation. As S. 611 clearly notes, the United States is unique in the world because it allows private industry to provide international telecommunications services. Even with the minimal amount of competition which now exists, American carriers and users have encountered difficulties in dealing with foreign administrations. To provide for wholesale deregulation might have serious disruptive effects on American users, particularly those who utilize international private leased circuits. Foreign administrations, particularly in Europe, might discontinue or restrict the use of such lines by American users if they believed that these lines were not subject to effective regulation.

ADAPSO also applauds the Subcommittee for recognizing the value of user participation in the formulation of United States international telecommunications policy. The benefits of such user participation have been clearly demonstrated by the success of the State Department's Public Advisory Subcommittee on Transborder Data Flows. This Subcommittee, by bringing together users, United States representatives to OECD, academicians, and others, has significantly contributed to the formulation of a sound and realistic United States policy with respect to transborder data flows. In ADAPSO's view, this experience can effectively and efficiently be applied to all aspects of international telecommunications policy and planning.

In a related vein, ADAPSO wishes to impress upon the Subcommittee the absolute need which exists for the United States to exercise more active leadership in the development of international telecommunications and information policies within such groups as the CCITT and OECD. At present, there are only four official United States delegations to represent American positions and protect American interests in more than 30 CCITT study groups and panels. It is absolutely essential that the United States take a more active role and positive leadership position within such groups, if it is to assure the establishment of policies which balance the needs of both providers and users of telecommunications services. This, in turn, will give users the flexibility to select services which best suit their needs from both a price and technical standpoint. In bolstering the size of United States delegations and thereby the leadership they can offer, the government should avail itself of the immense expertise available—in both the government and private sectors—to represent the United States on international telecommunications policymaking bodies. More often than not, such expertise is readily and freely available.

¹⁷ Appropriate statutory language reflecting this proposal is contained in Appendix I to this statement.

Further, it is recommended that some entity within the United States government be given the authority and responsibility to assure that, once international telecommunications policies are established, the United States takes all appropriate action to remedy violations. At present, there is no one government entity that is willing or has the power to take such action. As a result, the interests of American users often suffer at the hands of foreign administrations. The government agency which ultimately is given such power should also be directed to assure that American users can maximize the use of their international telecommunications facilities, unimpeded by non-tariff trade barriers or other protectionist restrictions. As an essential element of this power, the responsible government agency should be empowered to withdraw a service authorization or impose restrictions on the use of international facilities where such action is taken against American users. The presence of this power, in and of itself, will act as a deterrent to restrictive trade practices by foreign administrations.

Finally, it is recommended that the United States entity responsible for participating in international proceedings related to the construction and operation (initial and continuing) of telecommunications facilities be specifically directed to consider, and to take action to remedy, the actions of foreign governments or their agencies that use telecommunications facilities or services as non-tariff trade barriers. ADAPSO's member companies have encountered situations where a foreign organization will restrict an American data processing company's use of a telecommunications service in order to aid the position of domestic competitors. The United States must have the ability to respond effectively to this type of misuse of telecommunications services.¹⁸ Any lingering doubt concerning the statutory power of the responsible United States telecommunications agency to make foreign access to the United States contingent upon the elimination of non-tariff trade barriers to foreign markets should be clearly and unequivocally laid to rest.¹⁹

¹⁸ A copy of a recent ADAPSO petition to the Federal Communications Commission which discusses such a situation is attached as Appendix II.

¹⁹ Contrary to the position espoused by ADAPSO and other users, the Federal Communications Commission issued a decision last year in which it expressed doubts about its ability to compel foreign administrations to cease restrictive practices as the price of gaining access to the United States. See *ITT World Communications Inc.*, File Nos. I-T-C-2664-2, I-T-C-2658-2, I-T-C-2657-3 (July 12, 1978).

APPENDIX I

I. In order to assure that information software and services are not subjected to regulation by the Federal Communications Commission and in order to preempt regulation of such software and services by the States, ADAPSO recommends that Section 102, as proposed by S.611, be amended. ADAPSO also recommends that the assertion of federal jurisdiction over electronics equipment be more narrowly defined.

Section 102(a). The Congress finds and declares that, whereas modern efficient inter-exchange telecommunications services and facilities are essential to interstate and foreign commerce and whereas technological advances have led to a convergence of interexchange telecommunications services and facilities, such that it is no longer possible to distinguish between interstate interexchange and intrastate interexchange telecommunications simply on the basis of State boundaries without creating artificial and irrational barriers which are a burden on interstate and foreign commerce and which will reduce the benefits otherwise accruing to the public, the provisions of this Act shall apply to and the Commission shall exercise jurisdiction with respect to: all interexchange and international

telecommunications and all transmission of electromagnetic energy by radio, which originates and/or is received within the United States; all commerce in telecommunications and ~~electronics~~ telecommunications equipment and services, including electronics equipment intended to be connected with any telecommunications network; information software, and information services; the licensing and regulating of all radio stations as hereinafter provided; and all persons engaged within the United States in such telecommunications or such transmission of energy by radio or such commerce.

(b) Except as otherwise provided in title II, and subject to the provisions of section 301 of this Act, nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to charges, practices, services, facilities, or regulations for or in connection with exchange telecommunications services which do not form part of an interexchange service.

(c) No State or political subdivision thereof and no interstate agency or other political agency of two or more States shall enact or enforce any law, rule, regulation, standard, or other provision having the force and effect of law relating to the sale, lease, or other provision of information software or information services as defined by this Act.

Similarly, Section 203(d)(1) should be amended to remove any suggestion that the Commission has the authority to regulate information software and services either directly or indirectly. The Commission should be directed, however, to assure that its actions do not adversely affect competition in the information software and services market.

(d)(1) The Commission may establish and enforce such requirements with respect to design, manufacture, and maintenance standards for telecommunications equipment and electronics equipment intended to be connected with any telecommunications network as are necessary to protect such network from unacceptable technical or operational harm. ~~and to foster~~ The Commission shall assure that such interconnection requirements do not limit competition in the relevant

telecommunications equipment, electronics equipment, information software, and information services market or markets.

Section 203(g) should be deleted in its entirety.

II. S.611 amends Section 202 by empowering the Federal Communications Commission to vary the quality and quantity of regulation it exercises over carriers and their services. The Commission is specifically directed to exercise only so much of the power conferred upon it as is essential to achieve the purposes of the Act. ADAPSO fully endorses this approach to regulatory forbearance.

ADAPSO recommends, however, that the Commission be given somewhat more guidance by Congress in exercising this power to forbear regulation. Among other things, the Commission should be directed to consider the importance or essential nature of specific service offerings or facilities. Where a service or facility is essential and would not otherwise be made available unless subject to regulation, the Commission should formally recognize this fact and exercise its regulatory powers accordingly. Similarly, the Commission should be specifically directed to consider not only actual competition in a given market, but also the potential for future competition in that market. As part of this consideration, the Commission should evaluate the economic power

of present and potential market entrants and the ability they possess to engage in anticompetitive practices such as cross-subsidization and tying.

By directing the Commission to consider these factors, Congress will assure that deregulation takes place without any corresponding harm to competition or adverse impact on the availability of essential telecommunications services. The consideration of these factors will also assist the Commission in determining what types of regulatory safeguards are necessary and which requirements are superfluous. ADAPSO therefore recommends that Section 202 be amended as follows to provide the Commission with more specific guidance than that provided by the incorporation by reference of the policies of Section 201:

Section 202. In order to further the policy of section 201 of this title, the Commission shall exercise only so much of the powers conferred upon it under this title as is essential to the purposes of this Act, and shall, from time to time and whenever necessary, revise, reduce, or eliminate any rule or regulation prescribed pursuant to this title with respect to any telecommunications service or carrier operating in a market as competition develops, such

that the need for regulation or supervision accordingly diminishes. In determining the level of service or carrier regulation that is in the public interest, the Commission shall take into consideration the importance or uniqueness of specific transmission facilities or services, the level of actual and potential competition which exists in a given facility or service market, and the potential for anticompetitive conduct by any present market participant or potential entrant.

In order to fully implement the approach to regulatory forbearance suggested by ADAPSO, the following amendment of Section 205(a) is also required:

Section 205(a). Consistent with the purposes of this Act and the policy of this title, the Commission may prescribe different requirements for different categories or subcategories of carriers, different classes of services, or combinations of carriers and service classes. Provided, That, with respect to Category I carriers, the Commission shall impose no requirement except as otherwise specifically provided in this title.

III. ADAPSO proposes the following amendments of Section 103(11) to amplify and give additional substance to the maximum separation concept implemented by later provisions of S.611:

(11) "Fully separated entity" or "fully separated carrier" means an entity or carrier owned or controlled by or under common ownership or control with another entity or carrier which does not have common directors, officers, employees, operations, marketing, or financial structure, or commonly owned facilities with such other entity or carrier, and which deals with such other entity or carrier in the same manner (according to the same arms-length arrangements) as it deals with any unaffiliated entity or carrier, and which deals with such other entity or carrier pursuant to tariff when telecommunications services or facilities are involved.

IV. ADAPSO proposes the adoption of the following provisions in lieu of the existing provisions of Section 203(b), 204(b), 204(c), 204(d), and 204(e). As discussed in the supplemental statement to which this Appendix is attached, these proposed substitute provisions will implement ADAPSO's suggested

approach to the classification of carriers and the use of fully separated entities and carriers.

Section 204(a). All telecommunications carriers subject to this Act shall be classified and regulated, as more particularly set forth in this title, as either a Category I carrier or a Category II carrier.

(1) Category II shall include those carriers which undertake the construction, acquisition, extension or operation of a basic transmission facility.

(2) Category I shall include all other carriers.

(b) For the purposes of this section, "basic transmission facility" shall mean the line which constitutes the underlying pathway for transmission and shall not include a line created solely through the derivation or subdivision of an existing line, or the enhancement of the quality of service on an existing line, where the carrier dividing, subdividing, or enhancing such line obtains the use of the basic transmission facility under tariff from another carrier.

(c)(1) The Commission may, after notice and opportunity for hearing, forbear regulation of a Category II carrier as provided in section 202, but the burden of proof as to the appropriateness of forbearing regulation shall be upon the Category II carrier or carriers affected; provided, however, that if a Category II carrier elects to engage in activities permissible for a Category I carrier or to offer nontelecommunications services, it must do so through a fully separated entity or carrier.

(2) A fully separated entity or carrier affiliated with a Category II carrier may be classified as a Category I carrier, except that:

(A) the burden of proof as to the appropriateness of forbearing regulation shall rest upon the affiliated Category I carrier; and

(B) the affiliated Category I carrier may not itself offer any service other than a telecommunications service, as defined by the Commission, except through a fully separated entity.

(3) The Commission may, after notice and opportunity for hearing, modify in whole or in part the requirement of a separate affiliate prescribed by this subsection (c) if it determines that such modification, and the extent of such modification, are consistent with the purposes of section 202.

(d) A Category I carrier which is not affiliated with a Category II carrier may offer both telecommunications and nontelecommunications services and may not be regulated unless the Commission, after notice and opportunity for hearing, affirmatively finds a need to impose regulation with respect to services subject to its jurisdiction to achieve the purposes set forth in section 202.

As an alternative to the language of Section 204(c)(2)(B) quoted above, the Subcommittee may wish to consider the following provision in its stead:

(B) the Commission may impose upon the affiliated Category I carrier such conditions as appear appropriate, including the requirement that it undertake any activity other than a telecommunications service, as defined by the Commission, through a fully separated entity

for such time as may be necessary to assure that the Category I carrier's involvement in such activity results in substantial benefits to the public that outweigh potential adverse competitive effects.

This alternative expressly empowers the Federal Communications Commission to require maximum separation or, in lieu thereof, to impose such other conditions as may be in the public interest. This authority could be used to require the separate marketing of the communications component of an information service, to prevent tying, to prevent the bundling of service options, and to prevent other anticompetitive acts. This authority could also be used to ease the problems associated with the transition of the Bell System from the realm of pure monopoly into competitive markets. It is for this reason that the Commission is empowered to prescribe special conditions for as long or as brief a transition period as it deems necessary.

V. ADAPSO recommends the following amendments of Sections 203(c), 207 and 208(b), as proposed by S.611, in order to assure all users and carriers the rights of interconnection and service upon reasonable request and to prevent anticompetitive abuses associated with the bundling of services and equipment.

Section 203(c) should be amended to make its prohibition against the bundled offering of equipment and services applicable to all carriers. Such a prohibition is essential if the Congress does not adopt ADAPSO's proposed method of classifying carriers, discussed above. Otherwise, satellite carriers and carriers similarly situated would be able to engage in unfair competitive practices associated with the joint offering of a bundled communications/equipment/data processing service.

Section 203(c) No carrier ~~classified as a Category II carrier under section 204~~ shall offer telecommunications equipment as an integral part of a telecommunications service, except as the Commission may allow under such conditions as it may prescribe under section 205(b).

In order to assure that all users can exercise their right to interconnect terminal equipment that satisfies the requirements established by the Commission pursuant to Section 203(d)(1), ADAPSO proposes the adoption of the following provision as Section 207(c):

(c) Every carrier shall establish connection with all terminal equipment and terminal devices owned or leased by a customer which meet such standards as the

Commission may prescribe by order or by rule.

Finally, to assure that users can obtain service upon reasonable request, ADAPSO proposes a broadening of the obligation of Category II carriers to provide service. Specifically, ADAPSO recommends that Section 208(b) be amended as follows:

(b) Every Category II carrier shall make available, upon reasonable request therefor, any interexchange telecommunications service which it provides ~~and for which it is not subject to effective competition~~, and shall establish just, reasonable, and nondiscriminatory tariffs for and in connection with such service, and any such tariff that is unjust or unreasonable or that results in any unjust or unreasonable discrimination, preference, or advantage with respect to any person, class of persons, or locality, for or in connection with like telecommunications services, is hereby declared to be unlawful.

If the Subcommittee does not adopt the approach to the classification of carriers proposed by ADAPSO, the following alternative amendment of Section 208(b) would be necessary to assure that users can obtain needed service:

(b) Every ~~Category II~~ carrier shall make available, upon reasonable request therefor, any interexchange telecommunications service which it provides ~~and for which it is not subject to effective competition~~, and may not discriminate with respect to the rates, terms, and conditions for such service. Every Category II carrier shall establish just, reasonable, and nondiscriminatory tariffs for and in connection with such service, and any such tariff that is unjust or unreasonable or that results in any unjust or unreasonable discrimination, preference, or advantage with respect to any person, class of persons, or locality for or in connection with like telecommunications services, is hereby declared to be unlawful.

APPENDIX II

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D. C. 20554

In the Matter of)	
)	
WESTERN UNION INTERNATIONAL, INC.)	
)	
Application for authority to acquire)	
facilities and to use all existing)	
and future authorized facilities)	File No. I-T-C-2678-1
between the United States and Japan)	
for the provision of Database Service.)	
)	
In the Matter of)	
)	
RCA GLOBAL COMMUNICATIONS, INC.)	
)	
Application for such modification of)	
authority as may be required to pro-)	File No. I-T-C-2657-8
vide Low Speed Data Service between)	
the United States Mainland and Japan,)	
and beyond.)	
)	
In the Matter of)	
)	
ITT WORLD COMMUNICATIONS INC.)	
)	
Application for authority to utilize)	
its authorized facilities between the)	File No. I-T-C-2664-1
United States and Japan for provision)	
of Universal Data Transfer Service.)	
)	
To: The Commission		

PETITION TO DENY

The Association of Data Processing Service Organization Inc. (ADAPSO), by its attorneys, hereby petitions the Commission to deny: (a) the application of Western Union International, Inc (WUI) for authority to provide Database Service between the continental United States and Japan; (b) the application of RCA Global Communications, Inc. (RCA) for authority to provide Low Speed Data Service between the same two points and beyond; and (c) the application of ITT World Communications Inc. (ITT) for

authority to provide Universal Data Transfer Service between the continental United States, Japan, and as served via either or both such countries. Specifically, ADAPSO urges the Commission to deny the above-described applications unless their approval is conditioned upon:

- A. the removal of all restrictions currently being imposed on the use of private line circuits terminating in the United States by the applicants' foreign correspondent, Kokusai Denshin Denwa Co., Ltd. (KDD), that are inconsistent with applicable CCITT recommendations;
- B. the termination of all existing requirements that current subscribers of private line circuits transfer their communications traffic to the applicants' proposed service offerings; and
- C. the notification in writing by the applicants of all their current subscribers of private line circuits that all restrictions on the use of such circuits between the United States and Japan that are inconsistent with applicable CCITT recommendations have been removed and that the ability of subscribers to use such circuits will not be affected by the introduction of the applicants' proposed data services.

In support of this petition to deny, ADAPSO states that approval of the carriers' applications will not serve the public interest, convenience and necessity. In particular, a grant of Section 214 operating authority will facilitate the imposition of unlawful conditions on the use of private line circuits that will adversely affect the quality and cost of service to users, will undermine United States trade and economic policies, and will otherwise be detrimental to the best interests of the United States.

I. Identification and Interest of ADAPSO

ADAPSO is the principal trade association of the nation's 1,600 data processing service organizations. Many of its members offer the public a variety of remote access data processing services, whereby geographically distant customers can access the computers of ADAPSO member companies through the use of communications facilities. Usually, these facilities are telephone and telegraph grade lines such as private line circuits; sometimes, they are the value-added services of international record carriers. Because of their dependence upon a wide variety of international telecommunications services and facilities, ADAPSO's members are vitally interested in and directly affected by the terms and conditions pursuant to which basic and enhanced overseas communications services are made available by international record carriers.

II. The Proposed Service Offerings

The applications of the three international record carriers -- WUI, RCA and ITT -- describe virtually identical data communications services. Although each carrier's service bears a different name,^{1/} all three proposed offerings are designed to permit users to transmit and receive data on a fully automatic, two-way, half-duplex basis in digital form at speeds of up to 9600 bits per second between a host processor or data terminal in the continental United States and a corresponding

^{1/} WUI offers Database Service (DBS); RCA offers Low Speed Data Service (LSDS); and ITT offers Universal Data Transfer Service (UDTS). All are sometimes collectively referred to herein as specialized data services.

host processor or data terminal in Japan. The carriers' proposed data services utilize packet-switching techniques and are specifically designed for the overseas transmission of data between computers and between computers and terminals. These services can be accessed by users in the United States through the public switched network and through the communications networks of Tymnet, Inc. and Telenet Communications Corporation.

As the carriers' applications indicate, the proposed data services will be provided jointly with Kokusai Denshin Denwa Co., Ltd. (KDD), the carriers' correspondent in Japan. In addition to providing the matching half of transpacific satellite and cable facilities, KDD will market its own version of the carriers' specialized data services -- Valuable and Efficient Network Utility Service (VENUS) and International Computer Access Service (ICAS).^{2/} Access to KDD's data services in Japan will be possible through the Japanese switched telephone network and through dedicated private lines between the user's premises and the operating center of KDD. Charges for the Japanese data services will be computed, like their American counterparts, on a volume and usage sensitive basis. In view of the foregoing, KDD's involvement is an essential part of the applicants' proposed offerings and KDD's actions become a mandatory subject for Commission scrutiny.

^{2/} Throughout this petition, reference will only be made to VENUS, although it is not clear whether this is the name which will actually be used by KDD for its international service.

III. Background

Viewed in isolation, the three pending carrier applications for Section 214 operating authority appear to be no more than another in a series of requests to extend their respective data services to an additional geographic location. ADAPSO has traditionally welcomed such extensions of service and, in principle, has no objection to the addition of Japan as another location served by the specialized data services of WUI, RCA and ITT. Notwithstanding the foregoing, ADAPSO finds itself compelled to oppose the instant applications. Recent dealings by two of ADAPSO's member companies with the three international record carriers and their foreign correspondent have convinced ADAPSO that the extension of the applicants' data services to Japan is integral to, and will result in the maintenance and extension of, unlawful restrictions on the availability and use of private leased circuits.

The dealings of these two ADAPSO members with KDD and the applicants began in 1976, when Tymshare, Inc. (Tymshare) and Control Data Corporation (CDC) became interested in acquiring private line circuits between the United States and Japan. In December of 1976, Tymshare's Japanese affiliate, Kokusai Tymshare Ltd. (KTL), informally requested a private line from KDD between Tokyo, Japan and San Francisco, California.^{3/} KDD subsequently directed KTL to provide it with extensive background information about KTL, Tymshare, and Tymshare's network and computer services.

^{3/} See Appendix I.

KDD also instructed KTL not to formally apply to KDD for the desired private line until KDD notified KTL that it was the proper time to do so. By June of 1977, however, Tymshare was gravely concerned that KDD might never advise KTL to file an application and that, without a formal application by KTL to KDD, no date would be available upon which to base a complaint of unreasonable delay. Therefore, in June of 1977, KTL formally applied to KDD for a private line:

KDD refused to authorize or install this circuit unless certain specified conditions were satisfied. Among these conditions was the requirement that the requested circuit be connected to only certain specified computer systems in one specific computer center in the United States. In addition, KDD demanded that this circuit not be connected to any United States public network, including that of Tymnet, Inc., a separate arm's-length affiliate of Tymshare. Finally, KDD demanded that KTL discuss the use of KDD's new public data communications service, VENUS, when that service became available, in lieu of private line service. Confronted with the option of acceding to the demands of KDD or of not providing data processing services to Japan via the requested circuit, Tymshare and KTL acceded to KDD's conditions. On March 22, 1978, 16 months after the initial informal request for service was made, the private line circuit requested by Tymshare was finally installed.

The practical effect of the conditions imposed by KDD has been to impair Tymshare's ability to use its leased transpacific circuit efficiently. This is so because Tymshare

allocates primary responsibility for various data processing applications among its several different computer systems which are located at a number of different locations within the United States. Consequently, the only data processing services which Tymshare can offer in Japan are those which are processed on specific computers at one computer center attached to the leased transpacific circuit.

Tymshare has been advised, however, that the needs of its data processing network to access a number of computer systems can be satisfied through the use of KDD's VENUS service. Because VENUS is priced at usage sensitive rates, the service is not an economically feasible alternative for Tymshare. If Tymshare and KTL were forced to use VENUS, which appears to be at least 10 times more expensive on a unit cost basis than the cost of a private line, Tymshare's Japanese affiliate would be unable to compete effectively either with computer services which use computers located in Japan or with computer services provided in Japan which are connected via private lines to computers located in other countries.

CDC's experience has been similar. In early 1976, CDC requested RCA to install a full period private leased voice grade communications circuit between CDC's data processing center in Lakewood, Ohio and the Tokyo, Japan office of its Japanese affiliate, Data Services Far East, Japan Branch (DSFEJ).^{4/} As is true with respect to other of CDC's lines, the requested

^{4/} See Appendix II.

circuit was intended to be used to transmit processing information to and from terminal equipment located on the premises of customers of DSFEJ in Japan and CDC data processing centers located in the United States. KDD, however, refused to provide service and only after many months of negotiations was the requested circuit installed. In doing so, KDD offered CDC and DSFEJ the same choice it offered Tymshare -- agree to a contract which placed substantial restrictions on the use of the circuit or be prohibited from marketing data processing in Japan.

The major restriction imposed by KDD involves the United States terminus of the leased circuit. Much like the restriction it imposed on Tymshare, KDD demanded that CDC's leased circuit be connected to only a single computer system in a single location within the United States. In addition, KDD demanded that when VENUS became available, CDC would "respond to . . . [KDD's] consultation with a promise of transfer to this service" by CDC.

As is true of Tymshare, the effect of the first restriction is to inhibit CDC's ability to market its full line of data processing services in Japan. This result is a function of the structure of CDC's data processing network. In order to maintain as secure an environment as possible for its customers' data and to assure the continuous reliability of its services, CDC allocates production of its data processing services in a number of centers in various geographic locations. CDC's data processing network moves much data to and from customer terminals to its Lakewood, Ohio location from which

location it is diverted to other CDC data processing centers. Because primary processing capability for specific applications lies with specific processing centers, the only services which may be offered in Japan at the present time are those that are processed on a system in the Lakewood center.

In the last round of correspondence between CDC/DSFEJ and KDD, CDC was informed by KDD that the needs of CDC for geographic dispersion of processing could be satisfied with KDD's proposed VENUS service. Again as is true of Tymshare, the use of VENUS will not be economically or technically feasible for CDC/DSFEJ.^{5/}

Since the installation of the requested circuit in September 1977, representatives of CDC, DSFEJ, and ADAPSO have taken every step possible to have the above restrictions on private lines removed. These include: negotiations with the Office of Telecommunications Policy of the Department of State; negotiations with the International Programs Division of the Common Carrier Bureau of the Federal Communications Commission; negotiations with the United States Special Trade Representative; negotiations with the Joint United States-Japan Trade Facilitation Committee Staff, Bureau of International Economic Policy and Research, Department of Commerce; negotiations with the Telecommunications Secretary of the Embassy of Japan in Washington, D.C.; negotiations with the three applicants; negotiations with the United States Embassy in Japan by DSFEJ;

5/ See Section IV.C., at 21 infra.

negotiations by DSFEJ with the Japanese delegation to the CCITT; and, most recently, direct negotiations with all interested parties in Japan. It was in the hope that these most recent negotiations in Japan would be successful that ADAPSO requested an extension of time within which to file this petition to deny. At the present time, however, restrictions on the use of private line circuits are still being imposed on ADAPSO's members.

The foregoing recitation of events clearly demonstrates that American users have been subjected to unreasonable delays by KDD before being provided with private line service. It is also clear that KDD has imposed unreasonable restrictions on the use of such service and that these restrictions are extra-territorial in effect. Finally, it is apparent that KDD is effectively attempting to increase its rates by improperly restricting the availability of private line service.

IV. Approval of the Carriers' Applications Will Be Inconsistent With the Public Convenience and Necessity.

As the Commission and courts have found on a number of occasions, the public interest, convenience and necessity test is an all-encompassing standard that requires the Commission to examine a variety of relevant factors. ^{6/} At a minimum, it re-

6/ See, e.g., Pocket Phone Broadcast Service, Inc. v. FCC, 538 F.2d 447, 451 (D.C. Cir. 1976); Network Project v. FCC, 511 F.2d 786, 793 (D.C. Cir. 1975); Hawaiian Telephone Co. v. FCC, 498 F.2d 771, 776 (D.C. Cir. 1974); Carter Mountain Transmission Corp. v. FCC, 321 F.2d 359, 362 (D.C. Cir. 1963); Carroll Broadcasting Co. v. FCC, 258 F.2d 440, 443 (D.C. Cir. 1958); American Telephone & Telegraph Co., 52 F.C.C.2d 128, 134 (1975); RCA Global Communications, Inc., 47 F.C.C.2d 510 (1974).

quires that a proposed service offering be lawful and that it be consistent with the Commission's "primary objective" of promoting "rapid, efficient, Nation-wide, and world-wide wire and radio communications service."^{7/} On a somewhat broader level, the public convenience and necessity require that a particular offering be considered in the context of a variety of national policies, such as those favoring universal access to communications facilities and the free flow of information, and United States trade and economic policy. In every situation, however, the public interest, convenience and necessity require consideration of all the facts and circumstances which may be relevant in evaluating the merits of a particular communications offering.^{8/}

In the context of this proceeding, this means that the carriers' applications must be evaluated in light of the actions which their foreign correspondent has taken with respect to private line service. This is so because, by word and deed, KDD has inextricably linked private line service and the carriers' proposed data services. More accurately, KDD has linked re-

^{7/} 47 U.S.C. § 151 (1970); see Overseas Communications, 62 F.C.C.2d 451, 452 (1976).

^{8/} Carroll Broadcasting Co. v. FCC, *supra*, 258 F.2d at 443.

The basic charter of the Commission is, of course, to act in the public interest. It grants or denies licenses as the public interest, convenience and necessity dictate. Whatever factual elements make up that criterion in any given problem -- and the problem may differ factually from case to case -- must be considered. Such is not only the power but the duty of the Commission.

Id.; see note 6 *supra*.

restrictions on the use of private leased circuits to the introduction of its version of the applicants' proposed service offerings. Further, KDD, its capabilities, and its character are essential elements of the applications now pending before the Commission. Consequently, no evaluation of the carriers' applications can be complete without an evaluation of the above factors.

The first connection between private line service and VENUS was established by KDD by contract in 1977 and again in 1978, when KDD imposed the following condition on the Japanese affiliates of CDC and Tymshare as part of their private line agreements:

When "B" [KDD] shall start service through a new public data network called "VENUS" which is now under planning, A" [the American user] shall respond to "B"'s [KDD's consultation with a premise of transfer to this service by "A." 9/

Many months later, when the introduction of VENUS appeared to be imminent, KDD established the second and most recent connection between private line service and the carriers' specialized data services. In a letter dated February 1, 1979, KDD informed CDC that the restrictions that KDD had imposed on the use of CDC's private line circuit would not be removed. In doing so, however, KDD noted:

For your information, as you may be aware, KDD is planning to inaugurate new public data services coming spring and summer, called ICAS and VENUS, between US IRC's.

I believe that your requirement . . . will be fulfilled with our new services. 10/

9/ Appendix II, Attachment B, at ¶ 5.

10/ Appendix II, Attachment D, at 2.

In other words, CDC and, for that matter, all American users could avoid the restrictions KDD had imposed on the use of private lines if they simply began using VENUS.^{11/} The message is clear and so is the connection. Consequently, the pending carrier applications cannot be viewed in isolation.

Among the factors which the Commission should consider in evaluating the carriers' applications is the appropriateness of authorizing a service provided in conjunction with KDD in light of KDD's failure to comply with CCITT recommendations, its use of telecommunications facilities as non-tariff trade barriers, and its imposition of restrictions on American, as opposed to Japanese, users. In addition, the Commission should consider the impact on American users -- both in terms of price and quality of service -- of substituting usage sensitive services for flat rate services. Also, the Commission should consider the impact which approval of the proposed service offerings will have on the nation's balance of payments and on the position of the United States in future bilateral trade negotiations with Japan.

- A. Approval of the carriers' applications will be inconsistent with United States telecommunications policy.

On a number of occasions in the past, the Commission has "share[d] the concern of ADAPSO . . . over the continued

^{11/} The willingness of KDD to allow VENUS to be used in a manner that private line service cannot be used bears on the propriety of KDD imposing the restriction in the first instance. Indeed, this fact alone would appear to make the restriction on private line service an unreasonable discrimination in violation of Section 202 of the Act.

availability of private line services."^{12/} On one such occasion, the Commission explicitly recognized "the technical and economical advantages to large volume users inherent in the use of overseas private line services" and expressly held that "[s]uch services cannot be curtailed without appropriate authorization from the Commission pursuant to Section 214."^{13/} In doing so, the Commission was reflecting the longstanding United States policy in favor of the unrestricted availability of such circuits among nations.

The United States has forcefully, and perhaps most-cogently, made known its views with respect to private line service through its participation in Study Group III of the CCITT. In two contributions to that group, the United States has made it unequivocally clear that it was this nation's "firm position that leased circuits charged on a flat monthly rental basis remain available to all users who require them."^{14/} As concerns the use of these circuits by remote access data processors, it has also been made clear that the "continuation of leased circuits and networks for use in data processing systems and other customer activities is a matter of primary concern to the United States."^{15/}

^{12/} Memorandum Opinion, Order and Authorization, File Nos. I-T-C-2664-2, I-T-C-2658-2, I-T-C-2657-3, at ¶ 27 (July 12, 1978); see Graphnet Systems, Inc., 63 F.C.C.2d 402, 410 n.9 (1977), reconsideration denied, 67 F.C.C.2d 1020 (1978).

^{13/} 63 F.C.C.2d at 410 n.9.

^{14/} CCITT Study Group III, Contribution No. 35, at ¶ 5 (Feb. 1978).

^{15/} CCITT Study Group III, Contribution No. 34, at ¶ 8 (Feb. 1978).

The support of the United States for the continued availability of private line circuits has not been advanced without regard to the legitimate concerns of other nations. To the contrary, the United States has made it abundantly clear that it adheres to and enforces the legitimate CCITT restrictions imposed on the use of private line circuits employed "in conjunction with computers (data processing centres) operated by customers and providing data processing services to others."^{16/} These restrictions, which in essence prohibit message switching and

^{16/} CCITT, General Tariff Principles, Lease of Circuits for Private Service, vol. II.1, Rec. D.1, § 7 (1977) (Orange Book). The restrictions imposed on private line circuits used in conjunction with computers are essentially limited to the following prohibitions and conditions:

- a) leased circuits connecting users with a data processing centre may not be used for the exchange of information between user terminals either directly or on a store and forward basis . . . ;
- b) the transmission of messages between users having access to a data processing centre shall not be permitted through that data processing centre;
- c) the list of users thus connected or having access through the public networks must, upon demand, be communicated for agreement to the Administrations of the countries of residence of these users. Such information shall be held in strict confidence, taking into account national law or established practices including those with respect to right of privacy;
- d) the customer shall not be permitted to operate in the manner of an Administration by providing telecommunications services to others.

other communications between users, are fully supported by ADAPSO. Indeed, two annexes to a recent United States submission to CCITT concerning the procedures used to prevent improper message switching were prepared by two of ADAPSO's members, one of which is involved in the current dispute with KDD.^{17/}

As the appendices to this petition demonstrate and as discussed above, the restrictions imposed on the use of private line service by KDD go far beyond the restrictions contemplated by CCITT Recommendation D.1 and supported by the United States. Indeed, KDD's restrictions are so draconian that they have seriously diminished the economic utility of private lines to large volume users such as CDC and Tymshare. As such, KDD's actions are in direct conflict with established United States policy. Since approval of the pending applications will aid and abet KDD in the implementation of its restrictive private line policy, the carriers' applications cannot be approved without doing violence to well-established United States CCITT telecommunications policy.

The carriers' applications also cannot be approved for another reason. As noted above, discontinuance of service requires approval by the Commission pursuant to Section 214 of the Communications Act. Although KDD's imposition of restrictions on the use of private lines may not amount to a

^{17/} CCITT Study Group III, Contribution No. 38 (Feb. 1978).

discontinuation of service within the meaning of Section 214, these restrictions clearly constitute a reduction or impairment of service within the meaning of that section.^{18/} As such, KDD's actions, as implemented by the American carriers, cannot be undertaken unilaterally without a finding by the Commission that such action is consistent with the public interest, convenience, and necessity.^{19/} To curtail service without the intervention of the Commission is not only inconsistent with the public interest, it is unlawful. Similarly, since a carrier cannot lawfully impose restrictions or conditions on the use or availability of service unless such restrictions or conditions appear in the carriers' published tariffs,^{20/} the imposition of unpublished conditions on the use of private lines is plainly contrary to the public interest, as well as unlawful. As documented herein, the American international record carriers were unable to provide service in response to a demand for an unrestricted private line circuit.

^{18/} A de facto discontinuance or impairment of service requires Section 214 authority, as ITT and RCA should be well aware. See ITT World Communications Inc. v. New York Telephone Co., 381 F. Supp. 113 (S.D.N.Y. 1974); cf. Bunker Ramo Corp. v. Western Union Telegraph Co., 31 F.C.C.2d 449 (1971).

^{19/} See Graphnet Systems, Inc., *supra*, 63 F.C.C.2d at 410 n.9. The Commission's Rules are quite specific in this regard. See, e.g., 47 C.F.R. §§ 63.60, 63.61, 63.62, 63.500, 63.505 (1977).

^{20/} 47 U.S.C. § 203 (1970).

- B. Approval of the carriers' applications will be inconsistent with the best interests of the United States and its trade and economic policies.

Although all of the motives behind KDD's imposition of restrictions on private line circuits and its attempt to shift users to VENUS are known only to KDD, the effects of its actions are quite obvious. KDD has rendered private line circuits extremely inefficient and has made the only available substitute -- VENUS -- incredibly expensive. Consequently, if the carriers' proposed data services are approved, they -- in conjunction with the restrictions KDD has imposed on leased circuits -- will act as non-tariff trade barriers to American data processors wishing to operate in Japan. As such, the proposed services will be inconsistent with the public interest, since they will thwart United States foreign trade policy, which is opposed to the interposition of non-tariff obstacles to free trade.

As noted above, the restrictions imposed on the use of private lines by KDD inhibit the ability of American data processors to compete in Japan. This is so because American companies are unable to provide their full range of processing applications, since their private lines are limited to the use of specific computers or computer centers. A side effect of this restriction is to increase the unit cost of transpacific data transmission, since private lines cannot be used to transmit data unrelated to a particular computer center.

In order to compete in Japan with services processed on Japanese computers or with services processed by computers

in other countries connected via private lines to Japan, an American data processor has three choices -- none of which provides significant competitive relief. First, the American company can secure -- at unnecessary expense and after much delay -- additional private lines to each of its United States processing locations. This would result in several private lines being inefficiently used. Second, the data processor can reconfigure its United States facilities so as to aggregate its computing facilities into one system in one location. This would be a highly expensive and technologically unacceptable option.

The third choice, equally unacceptable, is for the data processor to transfer its service to VENUS and one of its American counterparts now under consideration. If this option were chosen, the American company would become an ineffective competitor and KDD would multiply its revenues.^{21/} A few examples demonstrate this point. At current rates,^{22/} an average low speed user (300 baud) who transmits 29,000 characters per hour would pay 8,820 Yen or \$44 per hour if using VENUS. A typical time-sharing vendor could provide the same service using a private

^{21/} In addition to increasing the carriers' revenues, a shift in traffic to VENUS would affect the services of remote access data processors and other users, by requiring them to use the protocols of the carriers' services and preventing them from designing their own networks based on transparent private line service.

^{22/} Assuming a conversion rate of 200 Yen per dollar, the proposed connection charge for VENUS is 3,600 Yen or \$18 per hour and the proposed transmission charge is 180 Yen or 90 cents per 1,000 characters. In addition, there will be a fixed monthly charge of 8,000 Yen or \$40 if local access is through the public network, or 15,000 to 17,000 Yen, \$75 to \$85, if local access is through a dedicated 1200 baud line.

line at 4,700 Yen or \$23 per hour without regard to the number of characters transmitted. If forced to use VENUS, the timesharing vendor's economies of scale would disappear.

Comparing a leased 9600 baud line and VENUS, the cost differential is astounding. If a fully loaded line is assumed to run six hours per day for 20 days a month using 50 percent of the maximum through-put of such a line, the revenue for KDD from VENUS would be over \$237,000. This is over 10 times the revenue KDD would receive for an equivalent leased line. If American data processors were forced to pay these much higher rates and increase their prices, they would lose their ability to compete effectively with their Japanese counterparts.

On the basis of the foregoing, it is clear that, if approved, the carriers' proposed data services will act as non-tariff trade barriers to American data processors operating in Japan. As such, they cannot be approved by the Commission consistent with the public interest and United States foreign trade and economic policies. Even if it is assumed that the KDD has no economic motives for its actions other than its singular view of what is a permissible use of private line circuits, the pending applications must still be denied since the effect of KDD's actions is still the same. However innocent, the fact remains that KDD is not attempting to enforce its view of what is proper in Japan; rather, it is trying to do so in the United States. This is clearly not proper. As the Commission has stated in a somewhat different, though relevant, context, "considerations of national sovereignty and international comity

require that no nation have a final unilateral determination with respect to facility deployment and use."^{23/} This is particularly appropriate where, as here, such unilateral action will act as a non-tariff barrier to commerce.

C. Approval of the carriers' applications will result in less efficient use of international and domestic telecommunications facilities.

As recognized by the United States in one of its submissions to CCITT Study Group III,^{24/} basic private line service has played a significant role in the growth and development of innovative data processing services. Through the use of sophisticated computer technology, both data processing service companies and private network operators have increased the quality and efficiency of private line circuits and have satisfied the highly specialized data processing needs of themselves and their customers. The impetus and incentive for this development has been the availability of unrestricted private line service at economical flat monthly rates.

The restrictions imposed on the use of private lines by KDD, however, discourage the efficient utilization of such circuits. Rather than encouraging the maximum amount of use possible, KDD limits private lines to the traffic which is generated or received by one computer site. As a practical matter, this means that private line circuits will operate at less than

^{23/} Overseas Communications, 62 F.C.C.2d 451, 457 (1976).

^{24/} CCITT Study Group III, Contribution No. 34 (Feb. 1978).

full capacity. Moreover, absent any need to improve transmission efficiency, the incentive which users normally have to develop new techniques or otherwise increase transmission speeds or accuracy will diminish.

In addition to a loss of efficiency in the use of private lines, KDD's actions will have another adverse effect on remote access data processors and on companies that wish to develop their own private computer networks. If CDC, for instance, were compelled by KDD to transfer its service to VENUS, CDC would incur unnecessary costs and be forced to use unnecessary equipment. This is so because many of the features offered by VENUS, UDTs, DBS, and LSDS are already present in CDC's own remote access data processing network.

The CDC network, for example, currently provides for a quality of transmission and error correction at least as good as that proposed by KDD and the American carriers. Thus, as far as CDC and its customers are concerned, the addition of the equipment and software proposed by the three applicants and KDD will be unnecessary and the costs thereof duplicative. In addition, the requirement that a customer use the regular CDC network and then interconnect to a special network will add needless complexities and costs. If compelled to use these specialized data services, CDC would be required to utilize additional equipment to interface its network with these specialized data services and to modify customer access procedures,

instructions, and training to accommodate the non-standard features of these specialized data services.

The Commission's "primary objective" under the Communications Act of 1934 is "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges" ^{25/} As the statute itself indicates, this responsibility extends to both domestic and international telecommunications. ^{26/} In light of this congressional mandate, the Commission cannot approve the pending applications because they are linked to KDD's impermissible restrictions on the use of private line service. It is clear that the public will not benefit from the inefficient use of international private lines and domestic data processing and communications facilities. It is equally clear that the public will not benefit from unnecessary requirements for duplication of communications equipment and services and the increased costs attendant thereto. As presented to the Commission in the context of KDD's actions, the carriers' applications will not serve "the present or future public convenience and necessity."

^{25/} 47 U.S.C. § 151 (1970).

^{26/} Overseas Communications, 62 F.C.C.2d 451, 452 (1976); Overseas Communications, 53 F.C.C.2d 121, 122 (1975).

V. The Carriers' Applications Cannot Be Approved Unless They Are Conditioned by the Commission.

For the reasons set forth above, it is clear that the carriers' applications cannot be granted consistent with the public interest. The Commission, however, can approve these applications if it exercises its authority under Section 214(c) of the Act and imposes three express conditions on the carriers' grant of authority. Specifically, the Commission can affirmatively act on the carriers' applications consistent with the public interest if their approval is conditioned upon: (a) the removal of all restrictions currently being imposed by KDD on the use of private line circuits terminating in the United States that are inconsistent with applicable CCITT recommendations; (b) the termination of all requirements that subscribers of private line service transfer to VENUS and its American equivalents; and (c) the notification in writing by the applicants of all their current private line subscribers that all restrictions on the use of such circuits between the United States and Japan that are inconsistent with applicable CCITT recommendations have been removed and that the availability and use of such circuits will not be affected by the introduction of the applicants' proposed data services.

In ADAPSO's view, all three conditions are necessary if the public interest is to be adequately protected. The three conditions are also reasonable. The first condition merely requires adherence to the existing international consensus on the

permissible use of private line circuits. Approximately a year ago, Working Party III/1 of CCITT Study Group III unanimously decided to retain the principle that leased circuit service should continue to be a communications user option. In addition, this condition effectively directs the carriers to satisfy their affirmative obligation "to make reasonable efforts to arrange for the necessary connecting facilities required locally and abroad."^{27/} In this case, the necessary connecting facilities would be unrestricted private line service.

The second condition removes the impermissible linkage which KDD established between private line service and the carriers' proposed data services. In other words, it requires that users be permitted to choose a particular service on its own merits, unrelated to any economic or other power which the service vendor may possess. This is completely consistent with United States communications policy.

The third condition, that current private line subscribers be advised of the elimination of restrictions on the availability and use of such circuits, is necessary for a number of reasons. To begin with, other users may have similar restrictions imposed on their use of private lines. Unless they are formally notified that these restrictions have been removed, they will continue to operate under the impression that they

^{27/} Mocatta Metals Corp. v. ITT World Communications Inc.,
54 F.C.2d 104, 116 (1975).

still exist. Second, other users may be under an obligation to transfer from private line service to VENUS when the carriers' applications are approved. In order to assure that users do not do so involuntarily, all private line users should be advised that they need not do so and that they can continue to utilize unrestricted private line service.

Only by imposing the above conditions will the public interest in the efficient use of limited telecommunications resources at reasonable costs be protected. In addition, these conditions will assure that the Commission does not promote non-tariff trade barriers and communications policies that are in fundamental conflict with American trade, economic, and telecommunications policies.

VI. In the Alternative, the Commission Should Conduct an Investigation and Hearing With Respect to the Connection Which May Exist Between the Proposed Data Services and Restrictions on the Availability and Use of Private Line Circuits.

If the Commission is not yet prepared to deny the carriers' applications or condition them as requested herein, it should, at a minimum, investigate and conduct a hearing with respect to KDD's actions in restricting private line service and promoting/requiring the use of the carriers' specialized data services.

A. Scope of the hearing.

Among other things, a Commission investigation and hearing should focus upon the agreements -- both disclosed and undisclosed -- which may exist between KDD and the three American

carriers concerning the introduction of the proposed data services and the availability of private line circuits.^{28/} As a preliminary matter, the Commission should call upon the applicants to file all agreements and reports of negotiations that pertain to the arrangements or understandings between KDD and any applicant concerning private line service or the applicants' proposed services. When received, these materials should be disclosed and interested parties should be invited to comment thereon.

The Commission should also investigate the extent to which KDD has imposed similar or other restrictions on other users of private leased circuits between the United States and Japan which are:

- (i) contrary to CCITT recommendations;
- (ii) imposed as total or partial non-tariff trade barriers to United States users;
- (iii) imposed on United States users, but not on Japanese or other users;
- (iv) not reflected in the tariffs of the international record carriers; and
- (v) not subject to removal at the request of this Commission.

All of these factors are relevant to the Commission's determination whether the pending applications are consistent with the public interest, convenience, and necessity. As noted above,

^{28/} Only WUI has even purported to file any semblance of an agreement with KDD along with its application.

the Commission is obligated to examine all of the relevant facts and circumstances surrounding a proposed service offering. As part of any hearing which the Commission may conduct, the carriers should be called upon to demonstrate what actions they have taken, if any, to have these restrictions removed. In addition, other users of international telecommunications services should be invited to participate.

B. Report to Congress.

If, for any reason, the Commission concludes that it lacks the power to take any action -- either with or without a hearing -- which would effectively eliminate the restrictions imposed by KDD on private line service, it should so advise Congress. In light of the consideration now being given by Congress to amendments of the Communications Act, such action would be especially appropriate. ADAPSO, however, is of the view that remedial legislation is unnecessary. The Commission currently possesses adequate authority to take meaningful action to regulate foreign communications.

VII. Conclusion

For the reasons set forth above, ADAPSO requests that the Commission deny the Section 214 applications of WUI, RCA, and ITT, unless the conditions enumerated above are imposed. In the alternative, the Commission should investigate these

applications and conduct a public hearing to consider the issues raised herein.

Respectfully submitted,

ASSOCIATION OF DATA PROCESSING
SERVICE ORGANIZATIONS, INC.

By: Herbert E. Marks

By: Joseph P. Markoski

WILKINSON, CRAGUN & BARKER
1735 New York Avenue, N.W.
Washington, D.C. 20006
(202) 833-9800

Its Attorneys

April 11, 1979

APPENDIX I
AFFIDAVIT

Alden Heintz, being duly sworn, deposes and says:

1. I am Vice President, International and Corporate Operations of Tymshare, Inc. (Tymshare), 20705 Valley Green Drive, Cupertino, California. In this capacity, I am personally familiar with the operation of Tymshare's international remote access data processing network. In addition, I have become directly involved in negotiations between Kokusai Tymshare, Ltd. (KTL), a Tymshare affiliate, and Kokusai Denshin Denwa Co., Ltd. (KDD) concerning the acquisition and use of a private line circuit between the continental United States and Japan.

2. Tymshare currently provides a variety of timesharing and remote access data processing services to a number of international locations, including Japan. Tymshare provides these services through the use of private line circuits, which it obtains from international record carriers. Because in the past these leased circuits have been made available in accordance with applicable CCITT recommendations, Tymshare has had the incentive to and has invested substantial funds in equipment, software, research and development to improve the quality and capacity of these circuits and to integrate them in Tymshare's specialized data processing network.

3. In December 1976, KTL informally requested a private line between Tokyo and San Francisco from KDD for the purpose of transmitting data between KTL customer terminal equipment in Japan and certain Tymshare data processing centers in the U.S.A. KDD instructed KTL to provide extensive background information about KTL, Tymshare, Tymshare's network, computer service, etc., but also instructed KTL not to apply formally to KDD for the private line until KDD told KTL it was the proper time to do so. By June 1977, Tymshare was gravely concerned that approval from KDD might never be given to KTL and that without a formal application by KTL to KDD, no application date would be available on which a complaint of unreasonable delay by KDD could be lodged by either KTL or Tymshare. Therefore, in June 1977, KTL finally made a formal application to KDD for the private line. The Japanese

carrier, KDD, refused to authorize or install this circuit unless certain specified conditions were satisfied. Among these conditions was the requirement that KTL and Tymshare agree that the circuit be connected only to specific computer systems in only one computer center location in the United States. In addition, KDD demanded that this circuit not be connected to any United States public network, including that of Tymnet, Inc., a separate arm's-length affiliate of Tymshare. Finally, KDD demanded that KTL consider the use of KDD's new public data communications network service known alternately as ICAS or VENUS at the time that KDD initiated such service.

4. Tymshare and KTL were confronted with the option of acceding to the demands of KDD or of not providing service via transpacific circuit in Japan. Accordingly, Tymshare and KTL have agreed, under protest, to KDD's conditions. On March 22, 1978, 18 months after the initial informal request for service was made, the private line circuit requested by Tymshare was installed.

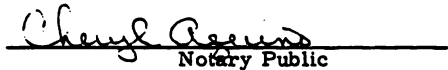
5. At the present time, Tymshare allocates primary responsibility for various data processing applications among its several different kinds of computer systems which are located at a number of different locations. Consequently, the KDD requirement that a private line circuit between the United States and Japan be connected to only one computer site in the United States inhibits Tymshare's ability to offer its full range of data processing services. This is so because the only services which Tymshare can offer in Japan are those which are processed on specific computers at one computer center attached to the leased transpacific circuit. Although Tymshare has a need for a private leased circuit which will enable it to efficiently use its data processing network, Tymshare has been denied such service.

6. The services offered by Tymshare are fully in accord with relevant United States regulations and with the Recommendations of the Consultative Committee for International Telegraph and Telephone of the International Telecommunications Union.

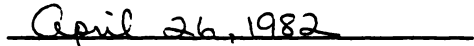
7. Tymshare has advised that the needs of its data processing network to access a number of competitive systems can be satisfied through the use of KDD's ICAS or VENUS service. VENUS, however, which is priced at usage sensitive rates, is not an economically feasible service for Tymshare. If Tymshare was forced to use ICAS service which appears to be at least 10 times more expensive on a unit cost basis for our purposes than the cost of a private line, our affiliate would be unable to compete economically in Japan with computer services based on computers located in Japan and also unable to compete with computer services provided in Japan via private lines connected to computers located in other countries.

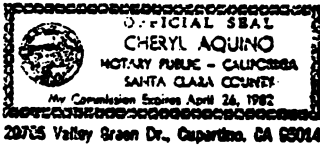

Alden Heintz

Subscribed and sworn to before me this 27th day of March, 1979.


Cheryl Aquino
Notary Public

My commission expires:


April 26, 1982



APPENDIX II

AFFIDAVIT

Phillip C. Onstad, being duly sworn, deposes and says:

1. I am Chairman of the International Competition and Data Communications Committee of the Association of Data Processing Service Organizations, Inc. (ADAPSO). I am also Manager of Telecommunications Policies for Control Data Corporation (CDC) and a duly authorized representative for Telecommunications Policies of Data Services Far East, Inc. (DSFE), a wholly owned subsidiary of CDC and Data Services Far East, Japan Branch (DSFEJ). I make this affidavit in support of ADAPSO's petition to deny the applications of Western Union International, Inc. (WUI), RCA Global Communications, Inc. (RCA), and ITT World Communications Inc. (ITT) for authority to provide their respective data services between the continental United States and Japan and points beyond.

2. In my capacity as CDC's Manager of Telecommunications Policies and as representative of DSFE and DSFEJ, I am personally familiar with the operation of CDC's international remote access data processing network. I am also familiar with and have participated in the negotiations which have taken place between DSFEJ and Kokusai Denshin Denwa Co. Ltd. (KDD) concerning the acquisition and use of a full period private leased voice grade communications circuit between the United States and Japan.

3. CDC utilizes such private leased circuits to provide remote access data processing services to various geographic locations throughout the world, including Japan. Because in the past these leased circuits have been made available by the international record carriers in accordance with applicable CCITT recommendations, CDC has had the incentive to and has invested substantial funds in equipment, software, research and development to improve the quality and capacity of these circuits and to integrate them in CDC's specialized data processing network.

4. In early 1976, CDC requested RCA to install a full period private leased voice grade communications circuit between CDC's data processing center in Lakewood, Ohio and the Tokyo, Japan office of DSFEJ. As is true with respect to other of CDC's lines, the requested circuit was intended to be used to transmit processing information to and from terminal equipment located on the premises of customers of DSFEJ in Japan and CDC data processing centers located in the United States. KDD, the Japanese carrier, objected to and refused to install the requested circuit. After many months of negotiations, the requested circuit was installed in September of 1977. The KDD, however, offered CDC and DSFEJ the choice of agreeing to a contract which placed substantial restrictions on the use of the circuit by CDC and DSFEJ or being prohibited from marketing their services in Japan. A copy of this contract appears as Attachment A to this affidavit. A memorandum addition to the contract provided that when KDD initiated its own public data service, DSFEJ

and CDC would be pressured to transfer service from the leased circuit to the new KDD data service. See Attachment B.

5. The major restriction imposed by the contract involves the United States terminus of the leased circuit. Specifically, the contract provides that the circuit can be connected to only a single computer system in a single location within the United States. The effect of this restriction is to inhibit CDC's ability to market its full line of data processing services in Japan. This result is a function of CDC's data processing network structure. In order to maintain as secure an environment as possible for its customers' data and to assure the continuous reliability of its services, CDC allocates production of its data processing services among centers in locations such as Lakewood, Ohio, Rockville, Maryland, Campbell, California and Minneapolis, Minnesota. In this manner, customer data bases and application processing are spread over a number of physical locations to provide safeguards including emergency back up. CDC's data processing network moves much data to and from customer terminals to the Lakewood location from which location it is diverted to various CDC data processing centers. Primary processing capability for specific applications lies with specific processing centers. However, the only services which may be offered in Japan at the present time are those that are processed on a system in the Lakewood center.

6. The geographic dispersion of processing functions performed by CDC's network does not allow the transmission of messages between customer terminals. As evidenced by Attachment C to this

affidavit, CDC has always taken precautions to inhibit the use of its network by customers for message switching. The services offered by CDC are fully in accord with relevant United States regulations and the Recommendations of the Consultative Committee on International Telegraph and Telephone of the International Telecommunications Union. Notwithstanding the foregoing, the Japanese authorities maintain that CDC's allocation of processing to various U.S. centers itself constitutes message switching which will not be permitted on circuits which connect in Japan.

7. Since the installation of the requested circuit in September 1977, CDC and DSFEJ have taken every step possible to have the above-mentioned restriction removed. These include: negotiations with the Office of Telecommunications Policy of the Department of State; negotiations with the International Programs Division of the Common Carrier Bureau of the Federal Communications Commission; negotiations with the United States Special Trade Representative; negotiations with the Joint United States-Japan Trade Facilitation Committee Staff, Bureau of International Economic Policy and Research, Department of Commerce; negotiations with the Telecommunications Secretary of the Embassy of Japan in Washington, D.C.; negotiations with the American international record carriers; negotiations with the United States Embassy in Japan by DSFEJ; negotiations by DSFEJ with the Japanese delegation to the CCITT. Although these negotiations have been continuing at all levels, the Ministry of Posts and Telecommunications has refused waiver of the restriction.

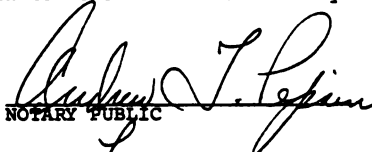
8. In the most recent correspondence between CDC/DSFEJ and KDD, CDC was informed that KDD would not attempt any further negotiations with the Ministry of Posts and Telecommunications in order to have the restriction on the use of CDC's leased circuit removed. KDD indicated, however, that the needs of CDC for geographic dispersion of processing could now be satisfied with KDD's new public data services, ICAS and VENUS. See Attachment D. These new data services, which are priced at usage sensitive rates, will be offered in connection with the specialized data services of WUI, RCA, and ITT. The use of these specialized data services will not be economically or technically feasible for CDC/DSFEJ since many of the features they offer are already present in CDC's own remote access data processing network. For example, the CDC network currently provides for a quality of transmission and error correction at least as good as that proposed by the applicants' services. Consequently, as far as CDC is concerned, the addition of the equipment and software proposed by the applicants is unnecessary and the costs duplicative. In addition, the requirement that a customer use the regular CDC network and then interconnect to a special network adds needless complexities and costs. If compelled to use these specialized data services, CDC would be required to utilize additional equipment to interface its network with these data services and to modify customer access procedures, instructions, and training to accommodate the non-standard features of these special data services.

9. During the week of April 1-7, 1979, at the request of KDD, I travelled to Tokyo, Japan to further discuss this matter with officials of KDD. During the course of these discussions, Japanese counsel for CDC/DSFEJ advised the parties that KDD itself could waive the restrictions it had imposed on the use of private line circuits, without the intervention of the Ministry of Posts and Telecommunications. I have been advised that KDD is now investigating this matter. As of April 11, 1979, however, restrictions are still being imposed by KDD on the use of private line circuits by CDC/DSFEJ.

10. I have read ADAPSO's petition to deny and the facts contained therein are, to the best of my present knowledge and belief, true and correct.


 Phillip C. Onstad

Subscribed and sworn to before me this 11th day of April, 1979.


 NOTARY PUBLIC

My Commission expires: May 14, 1982

ATTACHMENT A

CONTRACT OF INTERNATIONAL
LEASED LINE USAGE

Data Services, Far East, Inc. Japan Branch(hereinafter called as "A") shall conclude a contract as follows with Kokusai Denshin Denwa Kabushiki Kaisha (hereinafter called as "B") for usage of the international specified leased line between Tokyo and San Francisco(RCA)/Lakewood, Ohio jointly by "A" and Service Bureau Company, a Division of Control Data Corporation(hereinafter called as "SBC") based on the Public Telecommunication Law(issue No.97 stipulated in 1953):

Article 1:

"B" shall lease the following international specified leased line to "A."

(1) Covered area:

i) International : Tokyo - San Francisco(RCA)

ii) Local : Data Services, Far East, Inc., Japan Branch, Kowa Bldg. No.30, 2-4-5, Roppongi, Minato-ku, Tokyo - Tokyo International Circuit Line Control Bureau, 1-8-1, Ohtemachi, Chiyoda-ku, Tokyo

(2) Grade : Voice grade

(3) No. of Leased line: 1(One)

(4) Usage status: Data communication (4800 bps)

(5) Operating Hours: 24 hours a day

Article 2:

The line usage charge for the international area of the international specified leased line mentioned in the preceding article to be borne by Japan side shall be fixed upon receipt of the Minister of Posts & Telecommunications' approval.

Current Monthly Charge : ¥3,700,000.-

2. The usage charge for the local area of the international specified

leased line, etc. shall be fixed by Nihon Denshin Denwa Kosha.

Current monthly charge: ¥17,000.-

3. When modification of the charges in the foregoing such item shall be made, "B" shall notify the same to "A" at each occasion.

Article 3:

When "A" receives an invoice with regard to the line usage, etc. in the aforementioned article from "B", "A" shall pay the same to "B" by the end of the corresponding month.

2. Based on a separate agreement with SDC, "A" shall pay the line usage charge covering the U.S. side of the international specified leased line which should be paid to the common carrier, R.C.A. Global Communications Inc. by SDC, to "B" by the stipulated deadline date and "B" shall receive the same based on a separate agreement with R.C.A. Global Communications Inc.

Article 4:

When "A" shall not be able to use the international specified leased line for more than three consecutive hours due to reasons not attributable to "A" and its joint user, SDC, "A" shall not be called for paying the corresponding hours usage charge (the hours not necessary to pay by "A" are applied for in case of multiple figures of '3' only.)

2. When "A" shall become unable to use the international specified leased line, "A" shall promptly notify to that effect to Tokyo International Circuit Line Control Bureau where "B" belongs to.

3. The inoperative hours of the international specified leased line mentioned in item 1. shall count from the time of notice mentioned in the preceding item (or the time when Tokyo International Circuit Line Control Bureau shall learn it prior to "A"'s notice) till the time when "A" and "B" shall confirm the recovery mutually.

1/5 of the amount obtained by dividing the monthly usage charge in Article 2 by 30(hereinafter called as "Daily usage charge") for every three consecutive hours and if it shall be within 24 hours counting from the starting time of the first inoperative period, the usage charge not necessary to pay shall not exceed the daily usage charge in any case. If it shall exceed more than 24 hours, the relative exceeding hours shall be counted in the same manner as the above.

Article 5:

When "A" shall start or terminate the international specified leased line usage mentioned in Article 1 in the middle of the month, the monthly usage charge shall be calculated by multiplying the daily usage charge by the number of days used.

Article 6:

"A" shall jointly use the international specified leased line mentioned in Article 1 with SDC, only in case SDC shall offer CALL 370(Management Time Sharing Service) and CALL-PLUS(Watch service) (Hereinafter called as "Service") by using a computer installed in the same premises as SDC's in Lakewood, Ohio, U.S.A. to "A"'s customers in Japan.

2. The contents of the service, line usage status, etc. shall be as per in the application form submitted on June 25, 1977, by "A" to "B"(hereinafter called as "Application form").

3. When "A" shall modify the following among each item mentioned in the above application form, "A" shall notify to that effect in writing to "B" in advance and shall get its approval:

- (1) Business relation with SDC
- (2) Contents of service
- (3) Status of line usage
- (4) Installation site of computer
- (5) Any other which is considered necessary by "B"

Article 7:

The line usage concluded in this contract shall not be allowed as

media for the third party's communication or any other purposes for the third party, with the exception in the preceding article.

Article 8:

When the name and location of "A" or SDC shall be changed, "A" shall notify to that effect promptly in writing to "B."

Article 9:

When "A" or SDC shall violate the Public Telecommunications Law (Issue No. 97 stipulated in 1953), other relative laws and regulations, or the articles stipulated in this contract, "B" shall cease the line usage or terminate this contract.

Article 10:

Models, specifications, number of units, installation sites, etc. of the communication equipment for the international specified leased line usage to be installed and used by "A" shall be as per in the application form.

2. "B" shall acknowledge whether the communication equipment mentioned in the preceding item shall fit in the technical standards stipulated by "B" or not.

3. When "A" shall install the communication equipment already acknowledged by "B" according to the preceding item, "A" shall get "B"'s inspection and shall be allowed to use the same after receipt of "B"'s notice that the installation shall fit in the technical standards stipulated by "B."

4. "B" shall inspect the communication equipment installed by "A" any time when considered necessary besides the case in the preceding item.

Article 11:

In case increase of communication equipment installation, modification of the model, moving or termination shall be made by "A," "A" shall notify

to that effect to "B" in advance.

2. In case of additional installation, model change or moving of the communication equipment mentioned in the preceding item, "A" shall be allowed to use the communication equipment after receipt of acknowledgement and inspection mentioned in the preceding article.

Article 12:

When a necessity shall arise for adjustment of the equipment, testing the line, or switching over the frequency, etc. by "B," "B" shall notify to the effect to "A" and stop the line usage temporarily.

Article 13:

"B" shall limit the line usage hours in this contract or stop the operation in case of a natural calamity or any other emergency or force majeure.

Article 14:

"A" shall not be allowed to transfer the right made in this contract to a third party.

Article 15:

When a merge shall be made on "A," the existing corporation after the merger or an established corporation by the merger shall succeed the status of "A" mentioned in this contract.

2. The party who shall succeed in the status of this contract based on the preceding item, shall submit the report of succession together with the certified document as evidence of successor in this contract to "B" within one month from the date of succession.

Article 16:

This contract shall be effective as from 9/14/1977 and the valid period of this contract shall be one month counting from the effective date.

However, in case "A" or "B" shall not notify each other of the termination up until ten days prior to the expiration date, the period shall be extended for another month. The extension of the contract period henceforth shall be made in the same manner.

Article 17:

When this contract shall be modified, the modification shall be made upon discussion between "A" and "B."

As evidence of this contract, two copies of this contract shall be prepared and signed and sealed by respective parties and one copy each shall be retained by "A" and "B."

Date: 9/14/1977

"A" DATA SERVICES, FAR EAST, INC. JAPAN BRANCH

"B" KOKUSAI DENSHIN DENWA KABUSHIKI KAISHA
President and Managing Director: M. Itano

ATTACHMENT B

MEMORANDUM

DATA SERVICES, FAR EAST, INC. Japan Branch (hereinafter called as "A") and KOKUSAI DENSHIN DENWA KABUSHIKI KAISHA(hereinafter called as "B") shall conclude a memorandum as follows regarding the contract of the international specified leased line usage exchanged by "A" and "B" on 9/14/1977 :

1. "A" and SDC, its joint user in the U.S.A.(Service Bureau Company, a Division of Control Data Corporation) shall not be allowed to use the international specified leased line(hereinafter called as specified leased line) in different status other than the approval standard for the third party's usage of the telecommunication line stipulated by "B" upon approval from the Minister of the Posts & Telecommunications(hereinafter called as "Approval standard for third party's usage"). In other words, the relative data flow through this specified leased line shall be limited between one input/output device to one unit of computer mainframe and the data input from one input/output shall not be taken out to other input/output device without modifying the contents.
2. If "B" shall request the following material submission to "A," in order to confirm the fact that the specified leased line fit in the approval standard for the third party's usage and the data communication system which is linked to the circuit also fit in the approval standard for the third party's usage, "A" shall respond to their request. However, with regard to (1) below, submission once every three months shall be requested as a rule.

- (1) Names and addresses of the customers whom "A" shall let to use the specified leased line.
- (2) Reference manual(including COMMAND list) as service to be distributed to the customers whom "A" shall let to use the specified leased line.
- (3) Any other material to be considered necessary for the above-mentioned purpose upon consultation by both parties.

3. "B" shall be allowed to monitor the specified leased line at any time in order to confirm whether the incoming/outgoing communication status shall fit in the approval standard for the third party's usage or not.

4. If staff member of "B" shall enter the installation site with the facilities of data communication of "A" or SDC when such a necessity shall arise, in order to confirm the fact that the usage status of the specified leased line fit in the approval standard for the third party's usage, "A" shall respond to the request unless "A" has fair reasons to refuse.

5. When "B" shall start service through a new public data network called "VENUS" which is now under planning, "A" shall respond to "B"'s consultation with a promise of transfer to this service by "A."

Both parties have acknowledged the above items and signed herewith.

Date: 9/14/1977 "A" Data Services, Far East, Inc. Japan Branch

"B" Kokusai Denshin Denwa Kabushiki Kaisha
Sales Manager H. Nose



A N N E X 1

January 27, 1978

TO: Chairman, United States Delegation to
CCITT Study Group III

SUBJECT: Use of Communications Services by Data
Processing Services Organizations

Pursuant to your request, the following information is submitted on behalf of Control Data Corporation.

The United States Regulatory Agency established certain rules and regulations in its "Computer Inquiry" regarding the use of communications services by Data Processing Services Organizations, (DPSO's).

The content of these rules and the content of the D.1 Recommendations of the CCITT, prohibit a DPSO from using communications services it leases from domestic, international or foreign communications carriers to transmit information for its users which is not part of a "single integrated" data processing service. That is, all information transmitted must be directly related to the data processing applications or service provided by the DPSO.

Control Data Corporation is a major provider of many types of remote access data processing services. Control Data is fully aware that it runs the risk of having its communications service discontinued under the provisions of these rules and/or CCITT Recommendations or tariff provisions of the carriers if it allows users of its data processing services to transmit information over its data processing services networks which is prohibited.

Control Data's data processing services are very dependent on the use of private leased circuits throughout the world. Control Data has a continuing program to make certain that all rules, CCITT Recommendations and tariff provisions of communications carriers and Administrations pertaining to the proper use of communications services used in connection with its data processing services are being followed by Control Data and its users.

(1175)

CONFIDENTIAL - NO. 55-E

Although no data processing system is foolproof, Control Data has taken steps to design its systems to discourage the improper use of its data processing services in a manner which is prohibited by these rules.

In addition, Control Data takes the following steps and actions,

Special training sessions for its salesmen and customer service personnel to instruct them on the restrictions regarding the communications aspects of Control Data data processing services.

Customer sessions to inform them of the restrictions on the use of the Control Data Services.

Clauses in agreements training manuals and operations manuals and sign on procedures reminding the customer of the restrictions regarding the communications aspects of the data processing services.

Periodic checks of the system logs to attempt to spot any conditions which might indicate that a customer may be using the data processing service in a manner which is prohibited.

Further, Control Data has on file with all its international communications carriers and, upon request, will provide to any administration from which Control Data obtains communications services memoranda whereby Control Data agrees that if a carrier has reason to believe that a customer of Control Data's data processing services is using the service in any manner which is prohibited by the rules of the international communications carrier or Administration, and presents to Control Data some evidence of such violation, Control Data will:

Immediately meet with the customer to determine if the complaint is valid, i.e., that the service is being used in a manner which is not in compliance with the rules.

Remind the customer of the restrictions regarding the communications aspects of the data processing service and caution the customer that any use of the service which are not in compliance with the rules will force Control Data to cancel the customer's data processing services.

If the customer continues to use the service in a manner which is prohibited, after being warned, Control Data has agreed with the international record carrier to discontinue the customer's data processing service

Control Data feels that these procedures have been very effective as we have not received a single complaint from any communications carriers or Administrations concerning the misuse of the communications aspects of our data processing services.


Phillip C. Onstad
Vice President, Telecommunications Policies

ATTACHMENT D

KOKUSAI DENSHIN DENWA CO., LTD.

KDD BLDG. P.O. BOX NO. 1
 3-2, NISHI-SHINJUKU 2-CHOME
 SHINJUKU-KU, TOKYO 160, JAPAN

10 14 AM '79

REF.

CABLE ADDRESS: KDD TOKYO
 TELE: J22500 KDDTOKYO
 TELEPHONE: TOKYO 3-47-7111

Tokyo, February 1, 1979

Mr. Phillip C. Onstad
 Manager of Telecommunications Policies
 Control Data Corporation
 500 West Putnam Avenue
 Greenwich, Connecticut
U. S. A.

Dear Mr. Onstad,

I believe that we had very useful discussion over phone last Tuesday. I am pleased to write to you to make clear our situation and to give you further information.

1. Coming back to Tokyo, as I promised you in Geneva, I passed your desire to our Commercial Department which handles all such contract with leased line customers.

2. I was reported that Mr. Higashibata of 2nd Commercial Section who is in charge of this matter made contact to Mr. Tanabe of DSFE in Tokyo and replied that:

- 1) CDC application could not be accepted according to laws and regulations in Japan.
- 2) Such application should be submitted through Japan Branch of DSFE which is the party of the contract.

3. So, I was convinced that you had received this answer through DSFE branch already.

4. Any way, as for your proposed amendment of the contract, I can fully understand your intention of making it sure in the contract that CDC does not do nor allow its customers to do any message switching as you mentioned in Geneva and was attested by FCC representative Mr. Barbary.

I explained the situation faithfully to our Commercial Department, as I promised you in Geneva.

5. But, unfortunately, our regulation (precisely speaking, criteria in acceptance of applications for specialized leased circuits to be used by data processing customers) which was approved by the Government Authority clearly forbid the "line usage status" in which plural computers installed at separate locations could be accessed by the data processing customers.

6. This is just what I explained to you in Geneva, and the reason for this provision seems to be that so far as the CPU's are located in other countries we have no effective way to check whether these CPU's are mechanically or operationally separated from other terminals so as to avoid forming public network.

7. In this connection, though I fully understand what your draft amendment means, KDD has no intention at this stage to submit any amendment to the regulation for governmental approval.

8. By the way, it is reported these days that a movement forwards fundamental amendment of laws and regulations concerning data communication has been underway by the hand of the Ministry officials since the end of last year.

We are not sure whether actual draft will be submitted to the Diet in this session, but I think if the report is true, any other amendment in this field may not be accepted before this movement be settled.

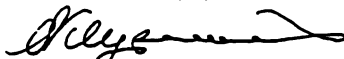
9. For your information, as you may be aware, KDD is planning to inaugurate new public data services coming spring and summer, called ICAS and VENUS, between US IRC's.

I believe that your requirement proposed in Geneva will be fulfilled with our new services. So, please contact to IRC's data service people if you are interested in our new services.

On our side, we are ready to make necessary arrangements with DSFE JAPAN at any time.

With best regards,

Sincerely yours,



Sei Kageyama

Deputy Manager
Tariff and Service Planning Department

Senator HOLLINGS. Thank you, sir.

Mr. La Blanc.

Mr. LA BLANC. Senator, the testimony I am going to give is slightly reworded from the prefiled testimony. The example is the same. I don't think you will find tremendous differences.

I am Robert La Blanc, vice chairman of the board of Continental Telephone Corp., a post I have recently assumed after 10 years with Salomon Bros., one of America's largest investment firms. My last responsibility in that firm was that of partner in charge, Telecommunications and Information Technologies Group. Prior to joining Salomon Bros., I served with the Bell System in varying capacities for 13 years.

As many of you know, the Continental System, although the third largest of the nonBell companies, is basically one of the most rural of rural companies. If measured in subscriber density, Continental's telephone base is made up of predominantly small exchanges serving rural America.

Of our 1,827 exchanges, over half are under 600 lines with the average size of all our exchanges just over 1,000 lines. A 600-line exchange supports a community of approximately 750 to 800 households and business establishments—communities like Show Low, Ariz.; Jackson, S.C., and others.

Even though Continental's assets are large, our subscriber base is basically drawn from rural areas, and in many cases, from people in low economic circumstances. We offer our rural subscribers the most advanced communication technologies available. Continental is planning right now to compete as widely and totally as economics, the law, and good business sense allow us. And, we will attempt to remain viable in either a competitive or noncompetitive arena as long as we can compete on equal terms.

We recognize that both S. 611 and S. 622 have as their major purpose the application of the advantages of competition and marketplace forces in place of regulation wherever possible. There are some areas in which this objective may be reached and provide affected publics with a very positive contribution.

After years of intensive debate, Continental still does not see how our subscribers in Greer, Ariz., with 150 lines, and thousands of communities of like size, will benefit from intercity competition either economically or technologically.

Despite access charges, basic maintenance programs, and technological hopes, our companies' subscribers living in more remote and lower-density areas will probably have to pay more for interexchange calls and local rates, and face a gradual deterioration of service.

My Wall Street experience proves to me that increasing the number of competing vendors of telecommunications facilities and services increases the risk of investment. Greater yield on corporate securities will be demanded, of course, to compensate for the increased risk. Fixed rate of return at levels considered adequate by Commissions today may or may not satisfy tomorrow's investors, thus increasing the costs to our predominantly rural subscribers.

The intent of both bills, to allow telecommunications companies greater freedom to move into diverse ventures within the telecom-

munications areas where they can maximize profit potential, is laudable but may not be realistic for a rural company such as Continental.

In addition, it is essential that the regulators allow us to separate our competitive and regulated business for ratemaking purposes, or the risks will outweigh the benefits for subscribers of companies like Continental.

While we are unconvinced of the immediate benefits of competition that will accrue to the Continental Telephone subscribers, let me address some of the details of S. 611 and S. 622.

We are extremely concerned with the wide latitude given the FCC in both bills to bring about the competitive climate. Both bills promise to keep the industry in even a greater state of flux and structural uncertainty than it experiences today, a situation which both bills are purportedly trying to correct. S. 611 sets no time limit on achieving deregulatory and competitive goals. We seriously doubt it is in the nature of a Federal agency to put itself out of business without being legislatively executed.

A phased approach to deregulation is essential to avoid adverse economic impact to the rural subscriber. It is not known whether immediate deregulation will cause harsh latent economic effects. We cannot jeopardize entire segments of the rural population by proceeding without caution. The effort toward deregulatory competitive goals must be gradual and certain in order to allow the industry and the subscribers to adjust.

Of particular interest to rural telephone companies is the broadband issue. Technological advances in the future will permit a single circuit to carry a wide range of services ranging from CATV to voice, probably all passing essentially as indistinguishable data in a digital format.

It is difficult to foresee how voice communications will be separable for regulatory purposes in such a situation. The public will certainly want to take advantage of all possible services that can be provided via a single, efficient, economic service, when technology and good business judgment permit.

Thus a competitive philosophy which would allow telephone companies to provide all types of broadband services, including broadcast retransmission, while permitting other companies to offer voice communications, should be included, we believe, in the legislative proposals. Whoever will take the risk of offering any or all of the broadband facilities or services to the subscribers, should be allowed to do so.

In regard to permitting telephone companies to compete on an equal basis with other companies in the provision of broadband services, an equitable depreciation program must be permitted. Otherwise, telephone companies will be unfairly burdened with technologically outmoded plants and the consumer will ultimately be disadvantaged.

It is indeed most difficult for us to comment on the quite different access charge and local exchange support mechanisms in both bills in the brief time allowed.

We note that both Senate bills recognize the requirement for a cost element reimbursable to the local exchange operator for origi-

nating, terminating and transferring interexchange traffic plus a separate support element for local exchange rates.

The declining contribution envisioned by these bills, if not counter-balanced by other sources, will require a corresponding increase in charges for local service rates. This transfer of burden appears to be contrary to the intent of the bills to keep local service rates affordable.

As an example, if the contribution were eliminated immediately, Continental would have to increase its charge for local service by 35 to 40 percent. Rather than make a detailed bill by bill analysis, we would like to offer what we believe is a less disruptive and equally responsive method to accomplish the aims of both bills.

We concur with the idea of an access charge and a separate charge for support of local exchange rates. Continental recommends that rather than impose a new and untested method of calculation of these two elements, existing separations be retained. Today's separations methodology can calculate both—an access charge based on unweighted relative use (SLU), with the local exchange rate support being the additional costs assigned to intercity services by use of current FCC/NARUC negotiated weighting (SPF) of intercity traffic.

Whatever method finally evolves, we firmly believe that the costs reimbursable to the local exchange operator for originating and terminating of interexchange traffic should be based on relative use of total commonly used local distribution facilities, not just those facilities that vary with the level of service provided (traffic sensitive).

This conforms to legal precedent that the usage of the facility involved should be recognized in the allocations of cost.

Today's separations formulas can be directly used to meet what appears to be the requirement for a transitional, declining level of support for local rates. This can be accomplished simply by reducing the weighting now given to interexchanged traffic. We have attached to this testimony an example of how this might be accomplished.

Methods of calculation of both elements should be specified on a uniform basis and address both the level of contribution, pooling of the contributed dollars and uniform redistribution back to the interexchange carriers.

We particularly oppose the idea of the FCC being the distribution agency for any funds for the basic exchange maintenance program. This would become a massive bureaucratic Federal program. The current separations and settlement procedure for internal distribution with Federal oversight, are adequate and have stood the test of time.

The existing separations and settlement procedures have evolved over years and years of complex industry, FCC and NARUC negotiations. If the current system is retained to determine these charges, the contractual arrangement among all the companies now providing this joint service can be maintained without disruption, and the impact on local ratepayers can be minimized. Otherwise, we foresee chaos for a long time to come.

Finally, we hope that whatever legislation evolves will take into consideration the need for a public network which can be effectively managed.

It is our belief that the telecommunications industry can manage itself, with recourse to the Commission and courts to police and control ethical conduct of all participants.

Strong enough antitrust protection should be written into the law to allow the affiliates of that network to work together efficiently and effectively, with existing antitrust laws being the framework for surveillance of these activities.

I thank you.

[The complete statement follows:]

STATEMENT OF ROBERT LA BLANC, VICE CHAIRMAN, CONTINENTAL TELEPHONE CORP.

Gentlemen, I am Robert La Blanc, Vice Chairman of the Board of Continental Telephone Corporation, a post I have recently assumed after 10 years with Salomon Brothers, one of America's largest investment firms. My last responsibility in that firm was that of Partner In Charge, Telecommunications and Information Technologies Group. Prior to joining Salomon Brothers, I service with the Bell System in varying capacities for 13 years.

As many of you know, the Continental System, although the third largest of the non-Bell companies, is basically one of the most rural of rural companies. If measured in subscriber density, Continental's telephone base is made up of predominantly small exchanges serving rural America. Of our 1,827 exchanges, over half are under 600 lines with the average size of all our exchanges just over 1,000 lines. A 600-line exchange supports a community of approximately 750-800 households and business establishments—communities like Show Low, Arizona; Jackson, South Carolina and others. Even though Continental's assets are over \$2.5 billion, our subscriber base is basically drawn from rural areas, and in many cases, from people in low economic circumstances. We offer our rural subscribers the most advanced communication technologies available. Continental is planning right now to compete as widely and totally as economics, the law, and good business sense allow us. And, we will survive in either a competitive or noncompetitive arena as long as we can compete on equal terms.

We recognize that both S. 611 and S. 622 have as their major purpose the application of the advantages of competition and market place forces in place of regulation wherever possible. We concede that there are some areas in which this objective may be reached and provide effected publics with positive contribution.

But, after years of intensive debate, Continental still does not see how our subscribers in Greer, Arizona, with 150 lines, and thousands of like communities will benefit from intercity competition either economically or technologically. Despite access charges, basic maintenance programs and technological hopes, our companies' subscribers living in more remote and lower-density areas will probably have to pay more for interexchange calls and local rates, and face a gradual deterioration of service.

My Wall Street experience proves to me that increasing the number of competing vendors of telecommunications facilities and services increases the risk of investment. Greater yield on corporate securities will be demanded, of course, to compensate for the increased risk. Fixed rate of return at levels considered adequate by Commissions today may or may not satisfy tomorrow's investors. The intent of both bills, to allow telecommunications companies greater freedom to move into diverse ventures within the telecommunications area where they can maximize profit potential, is laudable but may not be realistic for a rural company such as Continental. In addition, it is essential that the regulators allow us to separate our competitive and regulated business for ratemaking purposes, or the risks will outweigh the benefits for subscribers of companies like Continental.

While we are unconvinced of the immediate benefits of competition that will accrue to the Continental Telephone subscribers, let me address some of the details of S. 611 and S. 622.

We are extremely concerned with the wide latitude given the FCC in both S. 611 and S. 622 to bring about the competitive climate. Both bills promise to keep the industry in even a greater state of flux and structural uncertainty than it experiences today, a situation which both bills are purportedly trying to correct. S. 611

sets no time limit on achieving deregulatory and competitive goals. We seriously doubt that is in the nature of a federal agency to put itself out of business without being legislatively executed.

In this regard, a phased approach to deregulation is essential to prevent economic dislocation to the Continental Telephone rural and suburban subscriber. Of particular interest to us operating in rural areas, is the exploding and explosive broadband issue, inclusive of CATV. We would point out that technological advances are such that one day, a single circuit will carry a wide range of services from CATV to voice, probably all passing essentially indistinguishable data in a digital stream. How voice will be regulated as part of this stream is not easy to envisage. But, the public will certainly want to take advantage of all of these services, even in our remote areas, from a single, efficient, economic source, when technology and good business judgment permits. We suggest that the competitive philosophy in treatment of broadband in H.R. 3333, be considered for adoption in the Senate bills. Whoever will take the risk of offering any or all of the broadband facilities or services to the subscriber should be allowed to do so. If the CATV companies decide to offer voice in our areas and we do not meet the challenge, then we must accept the potential consequences. All we ask is an equitable depreciation program so that we will not be burdened unfairly with technologically outmoded plant.

It is indeed most difficult for us to comment on the quite different access charge and local exchange support mechanisms in S. 611 and S. 622 in this brief time.

We note that both Senate bills recognize the requirement for a cost element reimbursable to the local exchange operator for originating, terminating and transferring interexchange traffic plus a separate support element for local exchange rates. The declining contribution envisioned by these bills will require a corresponding increase in charges for local service rates. This transfer of burden appears to be contrary to the intent of the bills to keep local service rates affordable. As an example, if the contribution were eliminated immediately, Continental would have to increase its charge for local service by 35 to 40 percent. Rather than make a detailed bill by bill analysis, we would like to offer what we believe is a less disruptive and equally responsive method to accomplish the aims of both bills.

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Today's separations formulae can be directly used to meet what appears to be the requirement for a transitional, declining level of support for local rates. This can be accomplished simply by reducing the weighting now given to interexchanged traffic. We have attached to this testimony an example of how this might be accomplished.

Methods of calculation of both elements should be specified on a uniform basis and address both the level of contribution, pooling of the contributed dollars and uniform redistribution back to the interexchange carriers. We particularly oppose the idea of the FCC being the distribution agency for any funds for the basic exchange maintenance program. This would become a massive bureaucratic federal program. The current separations and settlement procedure for internal distribution with federal oversight, are adequate and have stood the test of time.

The existing separations and settlement procedures have evolved over years and years of complex industry, FCC and NARUC negotiations. If the current system is retained to determine these charges, the contractual arrangement among all the companies now providing this joint service can be maintained without disruption, and the impact on local ratepayers can be minimized. Otherwise, we foresee chaos for a long time to come.

Finally, we hope that whatever legislation evolves will take into consideration the need for a public network which can be effectively managed. It is our belief that the telecommunications industry can manage itself, with recourse to the Commission and courts to police and control ethical conduct of all participants. Strong enough antitrust protection should be written into the law to allow the affiliates of that network to work together efficiently and effectively, with existing antitrust laws being the frameworks for surveillance of these activities.

I thank you.

ATTACHMENT

EXAMPLE:

Allocation formulae now used:

Year

Now	$(.85 \times \text{SLU}) + (2.0 \times \text{SLU} \times \text{CSR}) = \text{SPF}$
1-4	$(.85 \times \text{SLU}) + (\text{SLU} \times \text{CSR}) = \text{SPF}$
5-7	$(.75 \times \text{SLU}) + (\text{SLU} \times \text{CSR}) = \text{SPF}$
8-10	$(.50 \times \text{SLU}) + \text{SLU} = \text{SPF}$
10+	SLU only - 0 contribution

EXAMPLE WITH VALUES:

	SLU = 8.40 CSR = 1.04			
<u>Year</u>		<u>Contri- bution %</u>	<u>Reduc- tion %</u>	
Now	$(.85 \times 8.40) + 2 \times 8.40 \times 1.04 = 24.612$	16.212		
1-4	$(.85 \times 8.40) + (8.40 \times 1.04) = 15.87$	7.470	53.9	
5-7	$(.50 \times 8.40) + (8.40 \times 1.04) = 12.93$	4.53	72.1	
8-10	$(.25 \times 8.40) + 8.40 = 10.50$	2.10	87.0	
10+	SLU = 8.40	- 0 -	100.0	

SLU Subscriber Line Use - Ratio of interexchange minutes of use to total minutes of use.

CSR Composite Station Ratio - Determined from average length of haul for study company. Represents price for an average call priced at a composite rate for that distance.

SPF Subscriber Plant Factor - The factor used to allocate telephone plant, expenses and reserves to the toll (inter-city) business. In the case of independent telephone companies, the result of this calculation is equal to toll revenues for this portion of the toll business. The difference between the SLU factor and the SPF factor is commonly considered the local exchange support element.

NOTE:

Even though the above example reduces the contribution to zero after ten years, legislation should provide for a review of the effect of this reduction on local rates, and provision made for retention of some level of contribution if deemed necessary.

Senator HOLLINGS. Thank you, Mr. La Blanc.

Mr. Garnett.

Mr. GARNETT. Mr. Chairman, members of the subcommittee, I am Wilson B. Garnett, executive vice president of Central Telephone & Utilities Corp. I am here today to express Centel's views regarding provisions of S. 611 and S. 622 relating to domestic telephone service.

I want to thank you for giving me this opportunity to appear before the subcommittee. Actually, this is the second time I have appeared here.

In March 1977 I testified on behalf of the United States Independent Telephone Association in my capacity as president of that organization. At that time I asked the subcommittee to consider certain issues regarding national telecommunications policy. Since then you have obviously worked hard to identify and study the issues and you have produced two bills to address them. I commend the subcommittee's efforts in this regard.

Today I will offer some brief remarks regarding three areas of concern that Centel has with these bills. With your permission, Mr. Chairman, Centel will also submit a detailed statement on a broader range of issues than can be dealt with here.

The three issues on which I will focus are: One, the impact of the bills on nationwide telephone service; two, some of the terms under which competition will take place; and three, the State-Federal jurisdictional boundary.

First, let me discuss nationwide telephone service. By that I mean basically interstate and intrastate toll telephone service, commonly called long distance. It would be included under the definition of "interexchange telecommunications" in S. 611 and "telephone toll service" in S. 622.

Both definitions seem to recognize that Nationwide Telephone Service is an end-to-end service. It includes the local distribution of calls, the recording of billing data, the issuance and collection of bills and interexchange switching and transmission.

All of those elements, plus others, comprise a single service, not only in the public's mind, but to the phone companies themselves; though facilities are separately owned, the activity is coordinated. Nationwide telephone service uses the facilities of every telephone company.

Centel markets that service in its areas in cooperation with other independent telephone companies, Bell Operating Co., and A.T. & T. Long Lines. We all pool our billed revenues, recover our costs, and earn the same return on our investments used to provide that service. So in a real sense, we are partners in a joint enterprise.

Some people may perceive Centel as primarily a local exchange telephone company. In fact, we are very much in the long distance business, which produces about half of our telephone revenues, and in which we have about \$525 million invested.

We have a big financial stake in that enterprise. We benefit from its successes and suffer from its failures. To illustrate, we estimate that for Centel a 1 percentage point change in the profitability of interstate long distance service means a \$0.13 change in our earnings per common share.

That gives us, and we believe also every other telephone company, the incentive to work hard to make sure that nationwide telephone service works well and is efficiently provided. We believe that customers who use that service benefit from the incentive mechanism which I have just described.

There is also a good deal of cooperative effort involved in the technical aspects of providing nationwide telephone service. It requires unified planning, management, and operation. The technical problems seem to get most of the attention, but the financial considerations also play an important role in the success of the service.

Centel is concerned that S. 611 and S. 622 as now drafted would undermine the financial process I have described and fragment that nationwide telephone service responsibility.

S. 611 would do so by discarding the existing jurisdictional separations procedures and related settlements and substituting an access charge and surcharge arrangement, which includes the basic exchange maintenance program. That fragmentation would be compounded by the fully separated entity requirement for the provision of interexchange telecommunications service by a carrier that also provides exchange service.

This arrangement splits the interexchange network away from the local exchange portion of nationwide telephone service. Instead of one economic enterprise, there would be many discrete profit centers, each concerned primarily with its own matters rather than nationwide telephone service as a whole. The financial incentive that exists today would be gone.

It is the current arrangement of jurisdictional separations procedures and related settlements that have helped to produce today's high quality service. Perhaps some changes are required—terminal equipment is an area that needs attention—but there has been no evidence at all that indicates that it should be abandoned. In our opinion, to do so would be a serious error.

An access charge approach may be entirely appropriate for providing exchange access to other services, but the access charge approach is inappropriate with respect to the joint provision of integrated nationwide telephone service.

We believe that the access compensation charge approach proposed in S. 622 suffers from some of the same maladies as S. 611, because it may result in the fragmentation of nationwide telephone service into stand alone local exchange and intercity elements.

Instead of fragmenting the service, both bills should be revised to recognize and encourage the economic and technical integration that are so necessary to keep nationwide telephone service as a viable and efficient enterprise serving the needs of the general public.

The second issue with which Centel is concerned relates to the terms under which established carriers and new entrants to the market will compete with each other.

We generally support the approach of the bills to open up telecommunications markets to competition, but certain provisions could stifle competition by restricting telephone company participation in the marketplace.

S. 611 is replete with provisions that appear to us to be designed to handicap established carriers so that their competitors are assured a share of the market. We are particularly concerned with portions of sections 101, 201, 203, 205, and 230 which could encourage the FCC to use the broad rulemaking powers it would be given under S. 611 to adopt a pattern of market allocation.

The FCC could block established carriers from offering any service, or utilizing any technology simply to protect competition. Other rules related to fully separated subsidiaries, tariff filing procedures, accounting procedures and ownership limitations could be used by the FCC to stymie the established carriers while new entrants captured whatever market share the FCC would deem to be appropriate.

We are equally troubled by the provisions of S. 622, which would give the FCC authority to establish virtually any market-allocating rules it wishes and which could be used to block certain carriers from providing certain services.

Instead of adopting policies that could be used to handicap telephone companies, the bills should be encouraging them to compete aggressively. This is particularly true with respect to nationwide telephone service. The companies that market this service should be permitted and encouraged to compete by exploiting all of the economies and technological capabilities of the nationwide telephone network. That way nationwide telephone service can continue to serve the general public as a healthy, growing enterprise that competes head on with other services that have been or will be brought to the marketplace.

The third and last issue that I will address in this statement is the State/Federal jurisdictional boundary question. Both bills would shift the current boundary so that intrastate toll service, which is currently regulated by each state, would come under Federal jurisdiction. The rationale underlying the proposed change is not clear at all to Centel. We believe that the question should be examined very closely before that change is adopted to be sure that the benefits outweigh the detriments.

Notwithstanding the merits of such a change, S. 611 is vague regarding just what authority State commissions would have. We understand that the intent is to assign the regulation of local exchange telephone service to the States.

However, 11 sections of the bill contain enough exceptions to that policy that the FCC could effectively exert total regulatory control over exchange service. Unless those sections are appropriately changed, they could be used to thwart the apparent intent of the bill regarding State commission jurisdiction.

S. 622 also contains language which could lead to an expansion of FCC jurisdiction beyond the scope that was apparently intended by the bill's authors.

In summary, Centel believes that the bills as currently drafted, would undermine the existing integrity of nationwide telephone service and, perhaps, adversely affect the overall quality of that service.

We are also concerned with certain provisions in the bills which could be used to handicap established carriers in favor of new entrants, thereby creating a process for the allocation of markets.

Finally, Centel believes that the reasons for expanding the jurisdiction of the FCC should be examined closely because the merits of such a change are not clear. Moreover, the new jurisdictional boundary itself is loosely defined so that the FCC could readily extend its authority beyond what these bills apparently intend.

Thank you very much for this opportunity to express Centel's views.

Senator HOLLINGS. Thank you, sir.

Mr. Inglis.

Mr. INGLIS. Thank you, Mr. Chairman.

My name is Andrew F. Inglis and I am president of RCA American Communications, Inc., a domestic satellite common carrier providing specialized communications services.

This statement presents RCA Americom's position on domestic common carrier provisions of S. 611 and S. 622.

I am submitting as part of this statement an exhibit containing a more detailed description of RCA Americom.

We believe that selective amendments to the Communications Act of 1934 are desirable. These amendments containing a positive statement of purpose in favor of diversity of ownership and competition among telecommunications media with provisions maintaining regulatory controls where they are required cannot help but have a healthy effect on the communications industry.

We also agree with the philosophy that regulation is workable and worthwhile only to the extent that the normal forces of competition that are relied on in most segments of the U.S. economy do not work to achieve the goals specified in the bill.

My experience for most of my career has been in the manufacturing businesses where strong competition prevailed, and I have found that such competition gave benefits not only to consumers, but also forced industries to be efficient, well managed, and innovative in order to survive.

I personally believe in the competitive process and accept the fact that competition means some competitors win and some lose.

Unfortunately, a truly competitive environment cannot be achieved under the current industry structure merely by the complete elimination of regulation.

As the subcommittee is aware, the communications industry is completely dominated by the American Telephone & Telegraph Co., a company of enormous size, wealth, and ability to spend or lose money on some services without having any substantial impact on its total earnings.

Numerous statistics can be cited to this subcommittee on the size of A.T. & T. and that of the various carriers providing specialized communications services.

They all demonstrate the totally unequal nature of the companies.

RCA Americom has already had the benefit of the procompetition approach taken by the existing Commission under the framework of the Communications Act of 1934 and its recognition of the problems caused by A.T. & T.'s size.

RCA entered the domestic satellite field after the Commission announced a policy affording essentially open entry. We grew in an

environment where the Commission largely freed equal competitors from traditional rate regulation.

At the same time, the Commission recognized that this opportunity for growth would be real only if A.T. & T. were restrained from entering the domestic satellite private line market for a 3-year period.

The combination of these factors has led to a healthy domestic satellite industry.

The two bills before this subcommittee advance even further the legitimate role of competition while retaining ample regulatory controls over what has been termed category II carriers.

We would, however, like to direct the subcommittee's attention to three areas in the bills which are of concern.

These are: The basic exchange maintenance program, the public resource use fees, and the classification of carriers and services.

S. 611 calls for a new section 222 which would institute a basic exchange maintenance program. Under this section, interexchange carriers would be required to reimburse local exchange carriers directly for the actual costs of originating, terminating, or transferring interexchange telecommunications services.

In addition to paying for the cost of these facilities, a system of surcharges would be imposed on all interexchange carriers, apparently whether the carriers use the exchange facilities directly, indirectly, or not at all.

RCA Americom understands that the concept of payments to local telephone companies in excess of the cost of providing the facilities first originated as a result of the factual dispute surrounding MCI's Execunet service and whether it would be detrimental to the existing level of local and toll rates.

However, the legislative proposal goes far beyond an attempt at imposing surcharges on new types of telephone service such as Execunet which divert revenue from the MTS market and instead reaches all carriers and all services.

The imposition of surcharges on all traffic is unreasonable and unwarranted. Most of RCA Americom's service classifications make little or no use of local telephone facilities and do not divert any revenues from the local telephone companies.

Thus, the service we provide to RCA Alaska Communications, Inc. does not involve any local facilities and obviously no diversion from any telephone company since in fact RCA Alascom is the long lines telephone carrier in Alaska.

When RCA Americom provides service to programmers seeking to serve the CATV industry, only local television facilities are provided by the telephone companies.

Again, there is no diversion from the MTS market.

Finally, most of the service to the Government involves high speed data services between dedicated Earth stations on Government property. Few, if any, local facilities are involved and there is no traffic diversion. To the degree that there has been a problem created by services such as Execunet, the services I have just described have not contributed to it and should not be burdened with correcting it.

The surcharge also should not apply to traditional private line services which connect to the switched network only through PBX's or similar devices.

These point-to-point private line services have been offered for years without causing any massive loss of revenues to the MTS market.

At this time, I would like to depart from the text.

This text expresses RCA Americom's opposition to what we understood to be a proposed system of fees for nonbroadcast spectrum use based on market value and the only limit on the fees would be what any party would be willing to pay.

Subsequently, testimony and discussion at previous meetings of this subcommittee indicated this was not intended.

It was contemplated while fees would reflect market value with respect to license and some respective uses would have a higher fee than other uses, the total amount collected would not exceed the total processing costs incurred by the Commission.

If this is the intent of the bill, I would suggest that the second sentence of section 106(b)(1) be amended to read: "Such fees shall reasonably reflect the relative value of the license issued to the licensee and shall not in the aggregate exceed the total cost of the Commission of processing all licenses."

Also, a reference to sealed bidding and oral options will now be deleted.

The last major area of concern has to do with the section which specifies the classification of carriers and services.

Section 204(b) states that any carrier which provides only services which are each subject to effective competition and which is not affiliated with a category II carrier shall be designated and regulated as a category I carrier.

This section would cause RCA Americom to be classified as a category II carrier because RCA Global Communications, Inc., an international carrier, is by the terms of section 251(c) a category II carrier and is affiliated, as that term is defined in the bill, with RCA Americom.

Since the result was probably not intended by the drafters, we suggest that a provision be added stating that a category I carrier shall not be deemed a category II carrier solely because of its affiliation with an international carrier.

Obviously, if the bill were to become law as it now stands, RCA Americom would be at a serious competitive disadvantage with respect to other satellite carriers that could conduct their business with no regulation while RCA Americom had to comply with the full requirements intended for true category II carriers.

Additionally, it is possible that in the future a particular service offered by RCA Americom could fall within the definition of a category II carrier contained in the present proposal.

Even though this service may involve only limited facilities and generate small revenues, it would appear that under the proposal as now written, RCA Americom then would be classified as a category II carrier for all of its services.

While we have no opposition to complying with the full regulatory requirements applicable to category II carriers for category II services, it would be unfair and perhaps unintended that the re-

mainder of our services not enjoy the same freedom as other category I carriers.

We recognize that a new fully separated carrier could be formed with category I and category II services being handled by the separate companies.

However, the separation requirement involves separate directors, officers, employees, financial structure, and facilities. For a carrier of RCA Americom's size, such a separation is not reasonable.

At present, RCA Americom has fewer than 400 employees. There are only two orbiting satellites and relatively few Earth stations owned by RCA Americom.

Given this situation, I do not see how we could separate the employees or facilities without operational and financial chaos.

I, therefore, propose that the classification section be revised to handle a situation such as this. I note that section 205(d)(3) already contains a provision giving the Commission authority to waive the full separation requirement in the case of a carrier which provides interexchange service solely within a single state and also provides exchange service if it is determined that full separation would impose unreasonable burdens because of the size and nature of such carrier.

In summary, RCA Americom supports the basic objective of the bills to reduce regulation and to allow the forces of the marketplace to play their proper role.

We see a bright future ahead for the communications industry and enormous benefits to the public.

Thank you.

[The statement follows:]

STATEMENT OF ANDREW F. INGLIS, PRESIDENT, RCA AMERICAN COMMUNICATIONS, INC.

My name is Andrew F. Inglis and I am President of RCA American Communications, Inc., a domestic satellite common carrier providing specialized communications services. This statement presents RCA Americom's position on domestic common carrier provisions of S. 611 and S. 622. I am submitting as part of this statement an exhibit containing a more detailed description of RCA Americom.

We believe that selective amendments to the Communications Act of 1934 are desirable. These amendments containing a positive statement of purpose in favor of diversity of ownership and competition among telecommunications media with provisions maintaining regulatory controls where they are required cannot help but have a healthy effect on the communications industry.

We also agree with the philosophy that regulation is workable and worthwhile only to the extent that the normal forces of competition that are relied on in most segments of the United States economy do not work to achieve the goals specified in the bill. My experience for most of my career has been in businesses where strong competition prevailed, and I have found that such competition gave benefits not only to consumers, but also forced industries to be efficient, well-managed, and innovative in order to survive. I personally believe in the competitive process and accept the fact that competition means some competitors win and others lose.

Unfortunately, a truly competitive environment cannot be achieved under the current industry structure merely by the complete elimination of regulation.

As the Subcommittee is aware, the communications industry is completely dominated by the American Telephone and Telegraph Company, a company of enormous size, wealth, and ability to spend or lose money on some services without having any substantial impact on its total earnings. Numerous statistics can be cited to this Subcommittee on the size of AT&T and that of the various carriers providing specialized communications services. They all demonstrate the totally unequal nature of the companies.

RCA Americom has already had the benefit of the procompetition approach taken by the existing Commission under the framework of the Communications Act of 1934 and its recognition of the problems caused by AT&T's size. RCA entered the

domestic satellite field after the Commission announced a policy affording essentially open entry. We grew in an environment where the Commission largely freed equal competitors from traditional rate regulation. At the same time, the Commission recognized that this opportunity for growth would be real only if AT&T were restrained from entering the domestic satellite private line market for a three year period. The combination of these factors has led to a healthy domestic satellite industry.

The two bills before this Subcommittee advance even further the legitimate role of competition while retaining ample regulatory controls over what has been termed Category II carriers.

We would, however, like to direct the Subcommittee's attention to three areas in the bills which are of concern. These are: the basic exchange maintenance program, the public resource use fees, and the classification of carriers and services.

S. 611 calls for a new Section 222 which would institute a "basic exchange maintenance program". Under this Section, interexchange carriers would be required to reimburse local exchange carriers directly for the actual costs of originating, terminating, or transferring interexchange telecommunications services. In addition to paying for the cost of these facilities, a system of surcharges would be imposed on all interexchange carriers, apparently whether the carriers use the exchange facilities directly, indirectly, or not at all.

RCA Americom understands that the concept of payments to local telephone companies in excess of the cost of providing the facilities first originated as a result of the factual dispute surrounding MCI's Execunet service and whether it would be detrimental to the existing level of local and toll rates. However, the legislative proposal goes far beyond an attempt at imposing surcharges on new types of telephone service such as Execunet which divert revenue from the MTS market and instead reaches all carriers and all services.

The imposition of surcharges on all traffic is unreasonable and unwarranted. Most of RCA Americom's service classifications make little or no use of local telephone facilities and do not divert any revenues from the local telephone companies. Thus the service we provide to RCA Alaska Communications, Inc. does not involve any local facilities and obviously no diversion from any telephone company since in fact RCA Alascom is the long lines telephone carrier in Alaska. When RCA Americom provides service to programmers seeking to serve the CATV industry, only local television facilities are provided by the telephone companies. Again, there is no diversion from the MTS market. Finally, most of the service to the government involves high speed data services between dedicated earth stations on government property. Few if any local facilities are involved and there is no traffic diversion. To the degree that there has been a problem created by services such as Execunet, the services I have just described have not contributed to it and should not be burdened with correcting it.

The surcharge also should not apply to traditional private line services which connect to the switched network only through PBX's or similar devices. These point-to-point private line services have been offered for years without causing any massive loss of revenues to the MTS market.

The second matter of concern to RCA Americom is the proposal contained in Section 106 which would allow the Commission to collect fees for the use of the frequency spectrum. The fees would be based on the "fair market" value of the spectrum and the Commission would be empowered to use, among other devices, sealed bidding and oral auctions to determine that value.

As a common carrier, RCA Americom opposes this concept as being antithetical to the general purposes of making available telecommunications services at reasonable charges and encouraging diversity of ownership and competition among telecommunications media. I am not opposed, however, to the concept of all common carriers paying for the processing costs of the Commission incurred when it acts on applications filed by the carriers. Further, if the legislative concern is to cover all regulatory costs in excess of direct processing costs or indeed even to raise revenue, the most efficient and equitable manner in which to do this would be through a surcharge placed on all bills rendered by common carriers.

My opposition to the "market value" spectrum fee is four-fold. First, the application of fees would raise the prices for telecommunications services to users thereby acting directly against the expressed desire that prices for these services be kept as low as possible. It must be expected that any fees assessed would become a cost to RCA Americom of doing business and would be recovered from its customers. This action would result in higher consumer prices and would be directly contrary to the government's anti-inflationary program.

Second, the proposal would allocate the spectrum to those entities with the deepest pockets and not necessarily those that would use the spectrum in the most

innovative and competitive ways. As ever, the fear centers on AT&T with its investment base already in excess of \$90 to \$100 billion. It and other similarly investment-heavy telephone companies are in the position to out-bid practically all others for the spectrum. Even if the price were excessive, it would be insignificant to a company of its size and wealth. The incentive to use the spectrum efficiently, as opposed to merely preventing other carriers from using it or holding it for some vague future purpose, would not be that large.

The third reason is that the concept is artificial. It sells something that has no real economic cost, that is not being depleted by use, and to which title is not held by the United States.

The United States has not incurred any cost in the creation of the frequency spectrum. It exists by the laws of nature. Nor does its continued use deplete the resource. After whatever period of use takes place, the same quantity of spectrum is still there and can continue to be used indefinitely. Also, the spectrum is commonly recognized as an international resource available to all and purposely not subject to ownership.

These factors distinguish the spectrum from the sale of oil drilling rights on government property or other situations involving resources which may have definable cost, are depletable and which are owned by the seller. The more appropriate analogy is to the air space above the United States which is used by airlines for transportation purposes without any fee being paid.

The fourth reason is derived directly from the artificial nature of the price. RCA Americom is engaged in providing many different services: regular voice grade private line service, distribution of television to CATV operators and broadcast stations, and government service. Most of the services could be provided terrestrially at this time and perhaps all of them in the future. The terrestrial carriers use not only microwave but also cable facilities which would be free from any special fees on their construction. The additional cost of a spectrum fee could substantially alter the competition between carriers using different types of facilities thereby making it more advantageous to construct, for example, cable facilities and making services using such facilities available at a lower price to the customer.

RCA Americom believes that the only proper way for one technology to be fully and properly exploited is for that technology to be free of artificial restrictions on its use. To the extent that a price is levied on spectrum use, it cannot help but have some effect that would not otherwise be present.

It should also be recognized that communications technology is developing at a rapid rate and one type of transmission medium which would appear to have advantages today may suddenly become obsolete or at least cost-effective in the future. It was only in the early 1940's that it was stated before Congress in connection with the legislative hearings on what was to become of Section 222 of the Communications Act that the overwhelming economies of high frequency radio for transatlantic communications meant the end to submarine cables. Well within 30 years, not only high frequency radio almost entirely eliminated but it still appears that cable technology is keeping pace with international satellites, a technology then not even considered. Today, new transmission media such as fiber optics using lasers may well change the economics of telecommunications. It is, therefore, important to guard against anything which would artificially shift the balance against a specific technology.

As I stated in the beginning, RCA Americom is not opposed to paying the costs associated with the processing of its applications filed with the Commission. However, these fees should be levied on all carriers and not just those using the spectrum since Commission effort is expended regardless of whether the application is for a cable facility or satellite. The other costs incurred by the Commission in its regulatory effort should be financed with the general funds of the United States since the benefits of the regulation inure to the general public.

Nevertheless, if it is felt that Commission should be entirely self-sufficient, the costs in excess of direct processing cost should be recovered by means of surcharge on the bills of all carriers and not spectrum fees. Obviously, if only these costs were to be covered, the surcharge would be very small. The surcharge could, of course, be increased if the intent of Congress is actually to raise additional revenues rather than just make the Commission self-sufficient.

The surcharge approach is suggested because it would be applied to all common carriers and all customers in a uniform and non-discriminatory manner. Rather than selecting one class of carrier, or permitting the carrier to recover cost to it from a fee schedule from whatever group of customers it selected, the surcharge approach treats all carriers and customers in the same.

The last major area of concern has to do with the section which specifies the classification of carriers and services. Section 204(b) states that any carrier which

provides only services which are each subject to effective competition and which is not affiliated with Category II carrier shall be designated and regulated as a Category I carrier. This section would cause RCA Americom to be classified as a Category II carrier because RCA Global Communications, Inc., an international carrier, is by the terms of Section 251(c) a Category II carrier and is affiliated, as that term is defined in the bill, with RCA Americom.

Since the result was probably not intended by the drafters, we suggest that a provision be added stating that a Category I carrier shall not be deemed a Category II carrier solely because of its affiliation with an international carrier. Obviously, if the bill were to become law as it now stands, RCA Americom would be at a serious competitive disadvantage with respect to other satellite carriers that could conduct their business with no regulation while RCA Americom had to comply with the full requirements intended for true Category II carriers.

Additionally, it is possible that in the future a particular service offered by RCA Americom could fall within the definition of a Category II carrier contained in the present proposal. Even though this service may involve only limited facilities and generate small revenues, it would appear that under the proposal as now written, RCA Americom, then would be classified as a Category II carrier for all of its services.

While we have no opposition to complying with the full regulatory requirements applicable to Category II carriers for Category II services, it would be unfair and perhaps unintended that the remainder of our services not enjoy the same freedom as other Category I carriers. We recognize that a new fully separated carrier could be formed with Category I and Category II services being handled by the separate companies. However, the separation requirement involves separate directors, officers, employees, financial structures, and facilities. For a carrier of RCA Americom's size, such a separation is not reasonable. At present, RCA Americom has fewer than 400 employees. There are only two orbiting satellites and relatively few earth stations owned by RCA Americom. Given this situation, I do not see how we could separate the employees or facilities without operational and financial chaos.

I, therefore, propose that the classification section be revised to handle a situation such as this. I note that Section 205(d)(3) already contains a provision giving the Commission authority to waive the full separation requirement in the case of a carrier which provides interexchange service solely within a single State and also provides exchange service if it is determined that full separation would impose unreasonable burdens because of the size and nature of such carrier. A similar revision should be added which would allow less than full separation in the situation I have described.

In summary, RCA Americom supports the basic objective of the bills to reduce regulation and to allow the forces of the marketplace to play their proper role. We see a bright future ahead for the communication industry and enormous benefits to the public.

ATTACHMENT

RCA AMERICAN COMMUNICATIONS, INC.

The RCA domestic communications satellite system, the first such system to provide commercial satellite services in the United States, started serving customers in December 1973. Initial satellite services were provided using leased channels on Telesat Canada's Anik II satellite.

On December 12, 1975, RCA launched the first of its own satellites—RCA Satcom I—beginning a new generation of communications spacecraft. Each RCA satellite is capable of serving the 50 States with a wide range of communications services for government, business, and the media, including full transponder service on a dedicated basis. RCA Satcom I went into operation on February 28, 1976.

On March 26, 1976, RCA launched its second satellite, RCA Satcom II, doubling the communications capacity of the system. Today, both spacecraft are operating at capacity.

RCA Americom recently applied to the FCC for authority to launch a third satellite. When Satcom III is launched, RCA will be operating a three-satellite system dedicated to serving private and specialized communications needs. Current plans call for a NASA launch in the fourth quarter of 1979.

As shown below the revenues of the domestic satellite system have shown large percentage increases in every year:

1974	\$700,000
1975	2,200,000
1976	9,700,000
1977	17,700,000
1978	27,300,000

The company is organized into four business groups, each responsible for a distinct market:

Commercial Communications Services provides private leased channels of voice, data and facsimile communications to businesses.

Video and Audio Services provides point-to-point transmission and multipoint distribution of television, radio and news service programming. The industries served by this group include radio and television broadcasting, pay TV, cable TV and publishing. Full transponder leasing is also provided to other carriers and end users.

Government Communications Services provides voice, video and high speed data services dedicated to Federal Government users, including RCA earth stations at user locations. Twenty such stations form a growing government network.

The fourth group has recently been established and will be responsible for maintaining regular business relations and contact with RCA Alaska Communications, Inc.

RCA Americom connects major U.S. business centers with a growing network of RCA earth stations. Major RCA earth stations now are located near New York, Los Angeles, San Francisco, Chicago, Atlanta and Houston, serving these cities as well as Philadelphia, Washington, D.C., Wilmington and Dallas. Each station is equipped to simultaneously transmit and receive private line telephone traffic, data, radio and television.

RCA Americom provides special services for the government. The company builds, leases and operates dedicated earth stations for government agencies. Such facilities and services are currently supplied to the National Aeronautics and Space Administration (NASA), the Department of Defense (DoD), the National Oceanographic and Atmospheric Agency (NOAA), and the United States Information Agency (Voice of America).

RCA Americom owns and operates dedicated earth stations at NASA's Goddard Space Flight Center in Greenbelt, Maryland; the Jet Propulsion Laboratory in Pasadena, Goldstone, NASA's Dryden Flight Research Center at Edwards Air Force Base, Delano, Dixon, Sunnyvale and Monterey, all in California; Kokee Park on Kauai, Hawaii; Wallops Island, Virginia; Suitland, Maryland; Johnson Space Center (two) near Houston, Texas; White Sands (two), New Mexico; Offutt Air Force Base, near Omaha, Nebraska; Sioux Falls, South Dakota, and Thule, Greenland. The satellite communications control center serving NASA and other government users is located at Goddard. The Armed Forces Radio and Television Service has contracted for seven additional earth stations at U.S. bases.

A rapidly growing network of receive-only earth stations, which are owned by cable television systems, also operates in conjunction with the RCA Americom system. More than 1000 cable TV systems receive one to several channels of daily programming from pay TV, independent station, news, sports distributors and religious broadcasters via RCA satellite.

The RCA Satcom spacecraft features several technological innovations. Advances in design and construction permitted a Thor/Delta launch vehicle to put a 24-channel spacecraft into orbit. This compares with the 12-channel satellites that previously represented the maximum weight that could be launched by that class of rocket.

The three-axis attitude control used on the RCA Satcom satellites affords the communications payload extra weight and power margins over dual-spin satellites. The design also permits continuous full power operation of the RF (radio frequency) channels throughout the minimum eight-year life cycle of the satellite. In dual-spin satellites, the spacecraft is stabilized by spinning the main body while the antenna system is despun and pointed toward earth. The solar cells mounted on a drum-like body of spin-stabilized spacecraft are exposed to the sun for only brief portions of each spin of the body. In contrast, the three RCA Satcom satellites have silicon solar cells mounted on extended flat panels (75 square feet) that continuously face the sun to collect maximum solar energy efficiently.

The RCA Americom satellite's solar arrays can produce up to 740 watts of power, sufficient to power 24 transponders, charge the batteries and drive housekeeping functions. A system of nickel-cadmium batteries on board each of the RCA spacecraft supplies power to the satellites when they are operating in an eclipse condition.

The RCA satellites utilize three major advances in space technology that permit doubling of capacity for a spacecraft launch by a Thor/Delta rocket.

The three advances are:

1. *Cross-polarized antenna* with over lapping gridded reflectors fabricated from lightweight Kevlar material, which increases the satellite's capacity from 12 to 24 simultaneous color TV channels. Alternatively, each of these channels also is capable of carrying more than 1,200 one-way telephone calls of 64 million bits per second of computer data.

2. *Graphite fiber epoxy composite materials*, which achieve a two-for-one weight reduction over the customary invar material, used for the complex frequency filters.

3. *Solid state traveling wave tube driver amplifier (TWTA)* is used to decrease weight and improve reliability.

These innovations permitted a modified Thor/Delta rocket to send a 2,000-pound payload into geostationary orbit. The Thor/Delta 3914 was developed with NASA cooperation by the McDonnell Douglas Astronautics Company under an agreement with RCA. It marked the first time that private industry had set design requirements and provided funds for the development of a launch vehicle. The Delta 3914 also will launch Satcom III.

The RCA Americom satellites are kept in a geostationary orbit 22,300 miles above the equator to provide communications coverage of Alaska, Hawaii and the contiguous 48 States. Satcom I is located at 135° West Longitude¹ and Satcom II at 119° on the orbital arc. Satcom III, which is being prepared for launch to satisfy increased market demand, is proposed to occupy the 132° West Longitude orbital position.

The RCA satellites operate in the 4/6 GHz bands, with each RF channel having an allocated bandwidth of 40 MHz and a usable bandwidth of 34 MHz. The system uses the 5.925-6.425 GHz common carrier frequency band for transmission from earth stations to the satellites and the 3.700-4.200 GHz band for transmission from each satellite to the earth.

Senator HOLLINGS. On the matter, Mr. Inglis, of the fees, in order to clarify what was said about fees, it would be hoped the fees would have the effect of recovering overall costs of the FCC on National Telecommunications Information Agency, which is about \$80 million, and we had that kind of figure in mind.

We don't intend to cover only the processing costs of the FCC, which is only about \$30 million. S. 622 is limited to around \$30 million.

The intent, too, of course, was with respect to those who interconnecting with the local facilities, in trying to develop, as a matter of public policy with respect to public schools, we didn't want to create an economic incentive not to connect so they would all be going around and gradually then would finally all rely upon the local exchange service, and the regular telephone service we have in this country would begin to deteriorate if put in a competitive position.

We are trying to have competition but also recognize where we are and how to go about it in an orderly way.

We didn't expect you to endorse it, I might say that.

Mr. INGLIS. I hope I made it clear we are making a distinction between different types of service.

Our cable TV customers have no interconnection with any exchange at all but might be subject to the surcharge.

Senator HOLLINGS. That last item you expressed about the category II carrier, you only have 400 employees, you say.

RCA Americom has fewer than 400 employees. We can well consider that. What we are trying to do is not bring about further regulatory burden.

¹ A shift to 136° West Longitude has been requested upon the orbital insertions of Satcom III at 132° in order to achieve a four degree separation in space.

You have an unusually close experience with fully separated type subsidiaries, is that correct, Mr. Beach?

Mr. BEACH. That is true. Eight years of experience.

Senator HOLLINGS. Can you tell us something, whether it's possible to manage a company under such conditions?

I would like you to comment. Some say it has to be totally separated and wholly owned, not only just the accounting, directors, and everything else.

The others say it's impossible. I would like your comments.

Mr. BEACH. It worked quite well between IBM Corp. and the Service Bureau Corp. As you know, Mr. Chairman, in 1956, the IBM Corp. entered into a consent decree with the Department of Justice and among the provisions of the decree was an obligation to create a separate subsidiary corporation which the court and the Justice Department said should be called the Service Bureau Corp.

So it was created—this was before my period of association with it—by the transfer of personnel and assets and the requisite elements necessary for it to conduct a business.

Prior to 1956, I am told that the Service Bureau activity, which was the sale of data processing services by means of contract as distinguished from having in-house computer equipment, was done through IBM's data processing division, which was the sales division of IBM.

The general language of the decree called for a series of steps which were not proven burdensome whereby the Service Bureau Corp. was not given any advantage because of its ownership by IBM.

For example, when it ordered goods and equipment, it ordered them and received them and paid for them on a retail basis just as all the competitors of the Service Bureau Corp. did.

It had no priority in terms of deliveries. It went into the queue and when its name came up, it received delivery. As far as special equipment was concerned, when the Service Bureau Corp. ordered a special machine, the fact that that special machine was ordered and all the specifications concerning it were immediately made available to all of the Service Bureau Corp.'s competitors.

In order to keep track of what was going on—there was no such thing as joint selling or activities of that type—but to keep track of the historical behavior of the two companies toward each other, the IBM Corp. filed annually with the Department of Justice a detailed report of all its dealings during the previous year with the Service Bureau Corp.

It goes without saying that the IBM Corp. has been quite successful without the Service Bureau Corp. The Service Bureau Corp. has been successful, so successful that the Control Data Corp. sought to acquire it in 1972.

So I think the experience has been one of success, both for the parent and the sub.

Senator HOLLINGS. The parent in its operation—did the wholly owned subsidiary have any trouble obtaining its financing?

Mr. BEACH. This was before my time, but originally the Service Bureau Corp. was established by the transfer of sufficient assets and personnel so that in the mind of, I guess, both the court and

the Justice Department and IBM, it was capable of sustaining itself as an ongoing entity.

That proved to be true.

Senator HOLLINGS. I see.

Mr. Garnett, you cite 11 sections of the bill which contain enough exceptions to the State jurisdiction that FCC could effectively exert total regulatory control of exchange service.

Is one of those 11 sections our definition of interexchange telecommunications where we include in the definition the origination and termination of such telecommunications within exchange areas?

Is that one of the 11 sections you referred to?

Mr. GARNETT. I think not. Insofar as the description itself is concerned, no, sir. I could recite several of these for guidance.

Section 203(b) deals with the establishment of separate entities when an existing telephone company is providing both interexchange service and intraexchange service.

That section would in essence give the FCC some jurisdictional exercise over what the State commissions now have jurisdiction over.

It also indicates that local exchange carrier could also be classified as category II carriers. Section 204(a) directs FCC to classify the carriers which would include local exchange carriers.

Section 207(a) gives the FCC jurisdiction over the terms and conditions with exchange service carriers and the authority to prescribe these terms if the parties are unable to reach agreement.

Section 210(a) states that all category II carriers must file tariffs with the FCC for telecommunications services that are not affected subject to effective competition.

This could be interpreted as requiring the filing of the tariffs for even local exchange telephone service with FCC, we think.

Section 213(a) authorizes the FCC to make evaluations as stated in the section itself. That evaluation we interpret to mean evaluation of investment allocated or dedicated to the provision of connections with interconnected carriers for the development of the access charge, and if the evaluation placed on that particular portion of the investment by FCC varies from the evaluation placed on that by the State commission, we have a problem.

Section 222 gives FCC jurisdiction over the accounting systems, of course, which is essentially what they have at the moment.

Most State commissions adopted that.

Section 222 establishes access charges and the basic exchange maintenance charge and puts their administration under the FCC.

A joint board would implement this. However, it's my understanding that the joint board is advisory and the authority for approval action is still residing with the FCC.

Senator HOLLINGS. You state it would be inappropriate to request an access charge with respect to the joint provision of integrated, nationwide telephone service.

Do you mean that would forgo additional revenues from, say, A.T. & T., CCSA, and FX services?

Mr. GARNETT. I think CCSA and FX perhaps are services that are not specifically covered under the present separations and set-

lements—I agree there should be some charge arrangement for their connection to the local exchange network.

Senator HOLLINGS. Local carriers are not category II carriers until they do something else. Nearly all the examples, we can clarify this. Let me yield to Senator Schmitt.

Senator SCHMITT. Thank you, Mr. Chairman.

Mr. Beach, with respect to the Service Bureau Corp., are you a fully separate or wholly owned subsidiary of IBM?

Do you share facilities with them?

Mr. BEACH. We are no longer part of IBM.

Senator SCHMITT. It was created as a working subsidiary?

Mr. BEACH. Yes. The consent decree for a short period of time—I would defer to the language itself—permitted some common offices.

I believe 20 percent was the ceiling on common offices. IBM and SBC phased out of that relationship.

Don't pin me down to the time period, but it was not too many years.

Senator SCHMITT. Were offices and administrative services associated with those entities jointly used? Were legal services shared?

Mr. BEACH. There were some legal services provided at the IBM corporate level but for the most part, the day-to-day legal services requisite for the company's affairs were done in-house.

Senator SCHMITT. So it was not an arm's length relationship during that transition period, is that correct?

Mr. BEACH. One hundred percent? No. Perhaps 95 to 98 percent.

Senator SCHMITT. The concern we have heard expressed many times with some aspects of the bills is: What is the meaning of arm's length?

If it's interpreted very literally, then the arrangement that was established by the consent decree would probably not have been an arm's length relationship.

Mr. BEACH. I would say on behalf of ADAPSO, if a relationship were established under this bill comparable to the relationship that existed between IBM and Service Bureau Corp., the members of ADAPSO would be delighted.

Senator SCHMITT. A cost accounting system would require some kind of historical or statistical division of costs for shared facilities and services, is that right?

That is an issue. I would like to hear the comment of the representative of RCA which is part of a similar kind of corporate system.

Are there within RCA and affiliated entities jointly used facilities and administrative services, Mr. Inglis?

Do you think RCA has a literal arm's length relationship with its other corporate entities?

Mr. INGLIS. I will use the 98 percent of the relationship between RCA Americom and NBC, for example. NBC is a customer of ours. We try hard to sell them. We try equally hard to sell to CBS and ABC.

Senator SCHMITT. I heard.

Mr. INGLIS. We have just introduced a proposed new service which will make it easier. We finally decided this was economically a good system.

Easier for a small network to get started. This conceivably could have an adverse effect on NBC, although probably not large, but as president of RCA Americom, I had no pressure not to do this.

In fact, quite the contrary. Management encouraged me to do what is best for Americom.

Senator SCHMITT. But there are some jointly used facilities and administrative services. What is that 2 percent you mentioned?

Mr. INGLIS. For example, in our current headquarters in Piscataway, N.J., we lease space at a fair market value from RCA Globecom. We are building our headquarters building and will move into it a year from now.

There are a few other places where we lease facilities. But as far as the policy is concerned, it's completely separate.

We don't consult with them on pricing or what markets we will or won't go into and so on.

Senator SCHMITT. The critical element here is whether by corporate decision or by legislative or regulatory fiat, subsidiaries must be created.

A significant transition period will be required depending on the degree to which facilities and administrative services are shared.

Perhaps eventually we can get through the transition period but it may take some time.

Now, Mr. La Blanc, with respect to your testimony, I think you said you were going to send us details.

Mr. LA BLANC. I have.

Senator SCHMITT. The philosophy you expressed is very similar to S. 622.

For example, you talk about a competitive philosophy for broadband services which would allow telephone companies to provide all types of broadband services including broadcast retransmissions, while permitting other companies to offer voice communications.

We think we have done that; it's a question of interpretation of the language.

We did prohibit, except under waiver provisions, programing being offered by telephone companies. Would you care to comment?

Mr. LA BLANC. I read it like CATV, which is including not just programing but it's the operation of the head end where all the programs are put together and the distribution.

One of the things we say is we are primarily a rural company. Our smallest town has 40 subscribers. It's kind of difficult when you envision a town like that to say to yourself that you have to have a separate telephone company providing voice and a separate company providing cable television.

Senator SCHMITT. We agree. We are trying to find a way to handle that.

Mr. LA BLANC. If you can do both—technology, we will have a digital bit stream going into somebody's home which can provide all kinds of services.

You can say that is programing, you can't do a television company but—

Senator SCHMITT. We would agree but the question is how do you define the exemption? I think this is a point where you don't want that to happen.

That was the original purpose of the prohibition on programing. Then we said what about the rural situation. You probably ought to have a waiver or maybe an outright exemption.

Mr. LA BLANC. Even if you look at an area like Ridgewood, N.J., North Bergen County, there are technologically no reasons why cable coming into my house carries cable TV as well as my telephone line coming in wouldn't in the future carry every bit of information I need in the house.

To say that that has to be a different entity, I think, may be needlessly restricting today when you talk about a little town or big town.

It's worse in a little town because you have no scale at all. Even a large town, it seems to me, if the cable television producer or provider of services will be in a position to handle voice, alarm services or whatever, then certainly the person who is providing what we would today call telephone service ought to be in a comparable position.

If we really want to get that kind of competitive market. I think that we have to allow that kind of freedom.

Senator SCHMITT. Do you think when one company provides all the services in a particular area, it is a competitive environment?

Mr. LA BLANC. I think anyone who wants to come into a particular area to provide service should be allowed to.

Senator SCHMITT. Duplicate facilities?

Mr. LA BLANC. Yes. That can be expensive, but I guess I believe in the open marketplace. I believe if the CATV company wants to stick its neck out, it may not be economically feasible, but—

Senator SCHMITT. I believe in the open market, too, until it gets so open that it closes suddenly because one entity dominates. Then you need a different set of policies. We are searching for a way in which we can open up this marketplace and, at the same time, not make it so open that it closes on us sometime in the future.

That is why your testimony, as well as detailed inputs, will be very valuable to us, as well as everybody else.

I hope that the structure eventually created will be one in which the facilities are hopefully not duplicated but that there is open competition in services and that no one entity has, because of a market share position, an advantage over any other entity in the provision of services.

When you consider the provision of facilities, it is not quite so easy to establish a competitive environment.

Mr. LA BLANC. Philosophically I couldn't agree with you more. I have a tough time in my mind transitioning, and I guess we all do, when I think of some of the smaller towns we serve.

Senator SCHMITT. That is my next set of questions. It has to do with the transition.

We tried to build in a transition plan in S. 622. I am not committed to the detail in which the transition is outlined but almost everybody seems to agree that some kind of transition will be required and that it will vary depending on the type of particular activity we are talking about, with the possible exception of radio which we may be able to deregulate immediately.

How long should a transition period last?

Mr. LA BLANC. I think you could do it in a relatively short period of time; 2 or 3 years. It depends on the size of where you are talking about, and two is the definiteness that is involved.

In other words, if I am looking at some smaller rural community that I am serving, I am looking at those subscribers, I say to myself I have a couple of strikes against me vis-a-vis the total market. They are small. In most cases the loop length is longer and in most cases the expense to serve them is higher than other places.

If I lose contributions from tolls, I would have to make that up by increasing local rates, if I am allowed to by the local State commission, and get an offset, or I will introduce new nonregulated services that hopefully will be attractive enough to my rural subscribers to take it and over that facility can be made whole as far as the investment is concerned.

One of the problems with the transition period is that most of the subscribers we have are poorer than the average, if you will, and I am not sure today, as a wise man, that I know necessarily whether they are willing to pay for a burglar alarm service or some of these other services we may be able to technologically provide in the future.

So I have to say if I have a transition period, whether it is 3 years or 10 years, and it is definitive, it says this amount, this amount, this amount each year, then I can try on a combination of new services and of going with the local commission on local rates to try to make up the difference.

I am very hopeful, as you are, that we can develop for the rural subscriber an equality with the urban areas and offer them as many of the super services we see coming in the 1980's, the heavy data processing or extended services.

The only way to do it, because of the economics of the situation, is if you can do it at a profit. That means if you take something away or if there is a possibility it will be taken away, as long as I know what it is and it is phased over a period of time and I can plan for services, that is all I am really asking for.

Senator SCHMITT. Mr. Carr, do you have a comment on that?

Mr. CARR. You have a chicken and egg proposition. Transition will in large part be determined by how the bill, the final legislation, is structured, and when you go to divestiture, what forms of subsidiaries you use, if you use them.

If you consider our recommendation, where the Bell's communications resources are concentrated on the basic system, it might be a very short transition period.

At the other extreme you might need years if you had to make a transition to a large number of completely separate subsidiaries and test the accounting, the transfer of assets and people—it is hard to give you a single answer.

Senator SCHMITT. But some transition will be required. The complexity of it will determine its length.

Mr. CARR. I think that is true.

Senator SCHMITT. Mr. Beach?

Mr. BEACH. Yes. I think certainly—the Service Bureau Corporation had a transition period. It was fairly short. The court had to approve a majority of the board of directors for a period of 5 years. After 3 years there was supposed to be no more than 20 percent

leasing of real estate facilities. But the facilities themselves necessary to do data processing were transferred almost at once. So you said it correctly a moment ago when you said it depends on the complexities.

It would be presumptuous to try to anticipate exactly. I can't do it.

Senator SCHMITT. How detailed should Congress guidance to the FCC be in that transition period? Should we leave them discretion?

Mr. BEACH. Leave them with discretion, laying down broad principles or concepts to follow and trust the FCC to carry out the intent of Congress. You can't give them a detailed blueprint.

Mr. CARR. I would agree with one addition. I think it would be very important that a clear legislative history be developed for whatever form the final legislation takes and the drafting be done very carefully.

Some of the testimony that I have heard from this panel and earlier today indicates concerns about possible interpretation of the language. For example, a few minutes ago you said that's not what the bill intended.

Senator SCHMITT. That's why we have hearings.

Mr. CARR. We would agree with the concept of giving instructions to the Commission and giving them some discretion on how to implement them.

Clarity is necessary so that the regulatory process does not in fact occasion results Congress didn't intend.

Senator SCHMITT. Mr. Garnett or Mr. Inglis, do you want to comment?

Mr. GARNETT. Certainly a transition period is required and the period that is given for transition will depend upon the complexities, technologically as well as the economic aspect of it such as revenue dislocation problems in order to recover those revenues that might be lost as competition is introduced.

I think I would suggest that there not be a specific cutoff date for the end of the transition but that be left to the Commission with the oversight exercise of the subcommittee reviewing the progress that is being made.

Senator SCHMITT. There has been testimony here and my constituents agree that you should never leave the bureaucracy with discretion. A goal, even though it may end up being modified through oversight, is very useful for the Congress to establish. Then we can hold their feet to the fire and say, "Why aren't you meeting this goal or schedule?"

Mr. GARNETT. I heard similar comments with respect to the bureaucracy. I am still naive enough to have faith that they too are very carefully considering the public interest aspects of any matter which they consider, and I hope I can maintain that faith.

Senator SCHMITT. You are not from the western United States, apparently.

We have a great deal more problems with bureaucracies out there than apparently you have.

Mr. INGLIS. I can only speak as far as RCA Americom. We are operating in a highly competitive mode. Assuming we were classified as a class I carrier, we could make the conversion in zero time. How long it would take A.T. & T., I have no idea.

Senator SCHMITT. That is a much more difficult thing.

Mr. La Blanc?

Mr. LA BLANC. You mentioned something about it being more complex for A.T. & T. From my past experience, I want to point out that 20 percent of all corporate debt in the United States is in the communications industry. About 17.8 percent is A.T. & T. The ability to be able to restructure the debt component is difficult in this kind of arrangement.

Senator SCHMITT. Because you are a former partner of Salomon Brothers, I wanted to ask you the following:

The allegation was made in these hearings that requiring fully separate subsidiaries would have an adverse impact on the phone companies' ability to raise capital in the bond market. Would you care to elaborate or whether that is true or not?

Mr. LA BLANC. Separate subsidiaries and separate companies going into the bond market are dependent upon being a certain size. When there was the separation from IBM, assets were transferred and basically big brother set up a viable business to begin with. Depending upon how large the organization is will depend upon whether you have access to the bond market or not.

Senator SCHMITT. There is a certain critical mass beyond which it doesn't make much difference. The access is fairly equal.

Mr. LA BLANC. I wouldn't put it that far. We have access to the market and access to the market at what price? Up to a certain point, and we have seen this happen since about 1971 or 1972, a small company trying to get started didn't have access at all.

I will give you everything you want inferentwise still—no access.

Senator SCHMITT. But in the situation where those entities already exist there wouldn't be a total increase in aggregate cost. If there was, it would be borne by the ratepayer, presumably.

Mr. LA BLANC. That's correct. If you have 25 people providing service one person used to provide, each have their own costs involved. It is a question of getting access at all, saying you have to be a size to begin with that has meaningfulness in the marketplace.

Ours was over 600 little mom and pop companies and we are now 58 subsidiaries. Those 58, many of them can get access to the marketplace. Some of them can't.

We have a common holding company that basically runs it. Our 58 subsidiaries are large enough to have their own management running it, but rely for a lot of services on the parent company. If they needed those services themselves, the local rates would be higher. You don't need a full-time attorney at some point.

Senator SCHMITT. From the narrow perspective of the consumer rate problem, if a cost accounting system could be implemented, then that would not have the same impact on rates as a subsidiary.

Mr. LA BLANC. That's correct. We filed testimony some time ago. We felt in 3 years you could come up with a cost accounting system that would essentially accomplish what you wanted to without the need of going down the separate—

Senator SCHMITT. You filed that where?

Mr. LA BLANC. We filed that at FCC.

Senator SCHMITT. Have you outlined such a system?

Mr. LA BLANC. Yes. We basically said that if you took the business—I can give it in 1 second. If you took the business and looked at it as four separate businesses—equipment on the customer's premises, local exchange distribution service, long-haul transmission, and other services, whether they be manufacturing or supply or whatever, and if you assigned your costs and your plant in those kinds of broad categories, you could probably come up with a cost accounting system that would accomplish probably 99 percent of what you wanted in being able to look at it.

It is arbitrary, but you need an arbitrary allocation.

Senator SCHMITT. Have you formulated that suggestion in any more detail?

Mr. LA BLANC. I will supply the committee with a paper that we filed with the FCC that outlines this.

[The following information was subsequently received for the record:]

CONTINENTAL TELEPHONE CORP.,
Washington, D.C., May 4, 1979.

Hon. HARRISON SCHMITT,
Senate Office Building,
Washington, D.C.

DEAR SENATOR SCHMITT: I am enclosing Continental Telephone Corporation's submission to the FCC concerning the revision of the Uniform System of Accounts and Financial Reporting Requirements for Telephone Companies.

As you recall, this information was promised to you by Mr. Robert La Blanc, Vice Chairman, Continental Telephone Corporation, in his testimony before the Subcommittee on Communications, Senate Committee on Commerce, Science, and Transportation the afternoon of the third of May.

We will shortly furnish legislative language which will describe our proposed modifications to the separations and settlements process as described by our one sheet attachment to Mr. La Blanc's testimony.

On behalf of Continental Telephone, we appreciated the opportunity to appear before you.

Sincerely,

WILLIAM FRIEDMAN.

Enclosure.

BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, D.C.

CC Docket No. 78-196

IN THE MATTER OF REVISION OF THE UNIFORM SYSTEM OF ACCOUNTS AND FINANCIAL REPORTING REQUIREMENTS FOR TELEPHONE COMPANIES (PARTS 31, 33, 42 AND 43 OF THE FCC'S RULES)

To: The Commission

COMMENTS OF CONTINENTAL TELEPHONE CORPORATION

Continental Telephone Corporation ("Continental"), by its attorneys and pursuant to the Commission's Notice of Proposed Rulemaking ("Notice"), FCC 78-453, released July 21, 1978, hereby submits its initial comments in the above-referenced proceeding.

I. INTRODUCTION AND SUMMARY

A. Introductory statement

The Commission's Notice proposes comprehensive revisions in the Uniform System of Accounts ("USOA"), the prescribed financial accounting system for telephone carriers. Essentially unchanged since its inception in 1935 (Notice, ¶ 1), the current USOA focuses on company-wide financial and operating data and provides a basis for Commission review of overall revenue requirements (Notice, ¶ 4). The instant rulemaking proposes to restructure the USOA in order to generate detailed information by service which the Commission believes is essential for proper management and regulation in the current multi-service environment of the telecommunications industry (Notice, ¶ 5).

As the Commission notes (Notice, ¶ 14), its proposal is much more than a system of accounts. Rather, it is a complex data gathering and information processing system which will require substantial changes in telephone company record keeping practices, computer utilization, employee training and operations. Particularly for the smaller carriers, these changes could result in increased revenue requirements and the need for higher subscriber rates. Accordingly, while access to more detailed cost information is an important factor in the evaluation of the Commission's proposal, any new accounting and information system must also be assessed in light of its potential impact on various aspects of the telephone industry.

The Commission's Notice calls for comments concerning its proposed accounts and myriad other issues, including such diverse matters as jurisdictional separations (Notice, ¶¶ 39-41) and depreciation practices (Notice, ¶ 43). Moreover, the Commission has requested that criticisms of its proposal be accompanied by counterproposals. During the past six months Continental has assessed the Commission's proposed accounting and information system and the issues raised by the Notice in light of Continental's management needs, the impact of the proposal on company operations and the telephone industry, and its ability to provide the information sought on a cost effective basis. Continental has also devoted considerable attention to developing an accounting and information system which will meet the Commission's regulatory objectives while at the same time eliminating or mitigating several serious deficiencies inherent in the Commission's proposal.

Continental's alternative proposal, set forth below, provides a framework for a comprehensive accounting and information system that will facilitate both the management and regulation of telephone companies in a multi-service, competitive environment while minimizing the costs and burdens placed on smaller carriers by the Commission's revised USOA. Although its comments provide a basic foundation for the development and implementation of its accounting and information system, Continental feels that additional details should evolve in discussions between industry members and Commission staff. Such a collective development of these details will allow diversified insights to be reflected in Continental's conceptual approach and will ensure the operational feasibility of the finalized system.

B. Summary of Continental's comments

After briefly describing its overall company operations and its accounting structure, Continental presents its assessment of the Commission's proposal. Fundamentally agreeing with the Commission's objectives in revising the USOA, Continental believes that a more comprehensive accounting and information system is needed to adequately manage and regulate telephone carriers in today's multi-service environment characterized by growing competition and ever-changing technologies.

As discussed in greater detail below, the major deficiency with the Commission's proposal is that it is framed solely with the goal of aiding the Commission in its regulation of the Bell System. The Commission fails to recognize that non-Bell independent telephone companies, and particularly those carriers which serve predominantly rural areas, have management concerns and are subject to state regulatory pressures that render many aspects of the Commission's proposed system of accounts of little value to the companies or their regulators. Since these carriers are generally not subject to Commission rate regulation, there is no reason for them to incur the onerous costs associated with the Commission's proposal.

Indeed, due to prohibitive costs compliance with the Commission's proposal might be impossible for the vast majority of independent companies. The proposal assumes that all carriers have sophisticated data processing systems that can easily implement the Commission's revised USOA. This is simply not the case. Millions of dollars will have to be spent, even by companies that already have computer capabilities, in order to comply with the complex accounting and data reporting requirements. Additionally, sophisticated training will be required for craft and clerical employees to master the intricate details of the Commission's revised accounts. These training costs will be particularly burdensome for smaller carriers which will also experience productivity losses in complying with the proposed system.

After presenting its general comments on the Commission's revised USOA, Continental outlines its proposal for an alternative accounting and information system. The fundamental difference between the two proposals is that, unlike the Commission's, Continental's system will not report accounting data to detailed general ledger accounts. Rather, the underlying data records will allow for the direct assignment or allocation of costs, investment and revenues to four business segments, or markets, that delineate broad areas of the telephone industry. These business segments will reflect the evolving competitive structure of the industry and will provide both management and regulators with a necessary level of cost disaggregation. Under Continental's proposal, further disaggregation of accounting data can be

obtained by application of "service allocation procedures" that will allocate costs and plant investment to the various service categories. Continental's proposal is designed to achieve the desired objectives of a service oriented information system without the onerous cost burden entailed by the Commission's proposed use of detailed general ledger accounts.

Next, the comments discuss several issues raised by the Commission's Notice, in the light of Continental's proposal. Included are the problems raised by the Commission's proposed reconciliation within the general ledger accounts of FDC Methods 1 and 7 costs; the need to maintain the present structure of plant accounts for depreciation purposes; the appropriate treatment of plant under construction; the use of separate accounts for "common" and "fungible plant"; and the proper treatment of maintenance expense. Several other issues raised by the Commission's Notice are addressed in Appendix A attached hereto.

II. DESCRIPTION OF CONTINENTAL TELEPHONE CORP.

A. Overall operations

Continental, founded in 1960, is the third largest independent (non-Bell) telephone holding company in the United States. As of September 30, 1978 the Company's telephone operating subsidiaries served approximately 2,770,000 telephones through 1,832 exchanges in 40 States, Canada and the Caribbean. Most of these exchanges are located in suburban communities, small towns and rural areas; 67.4 percent are two-party, 21.6 percent are four-party and 6.9 percent are more than four-party. Continental provides 100 percent dial service.

Continental provides local and toll services in the areas in which it operates. The Company's central offices and toll lines are connected with the nationwide toll network of the Bell System and with other independent telephone companies, permitting toll service to and from areas outside those served by the Continental System.

Administratively, Continental's domestic telephone operations are divided into three regions. Eastern regional headquarters are located at Dulles International Airport near Washington, D.C.; central regional headquarters at St. Louis, Missouri; and western regional headquarters at Bakersfield, California. Corporate headquarters are located at Atlanta, Georgia. A subsidiary, Continental Telephone Service Corporation, provides managerial, financial and other services to Continental's operating companies. Other subsidiaries offer data processing, general purchasing, directory publishing, and other specialized services.

Continental's domestic telephone operations are managed through 44 operating subsidiaries, which are the surviving companies of the merger, consolidation and combination of literally hundreds of small telephone companies acquired by Continental in a period of less than two decades. Of these 44 telephone operating subsidiaries, 9 companies account for 57 percent of the total main stations, leaving 35 companies with an average of approximately 21,000 main stations each. Continental's exchanges serve an average of less than 1,000 main stations. Due to this low density, Continental's subsidiaries have high per station investment and operating expenses.

The relative sizes of Continental's telephone operating companies are shown in the following table which classifies the companies according to total annual operating revenues. As reflected therein, 36 companies, comprising over 80 percent of Continental's telephone subsidiaries, have annual revenues of less than \$25 million.

Annual revenue classification:	Number of companies
Under \$2 million.....	3
\$2 to \$3 million.....	8
\$3 to \$4 million.....	5
\$4 to \$5 million.....	2
\$5 to \$10 million.....	7
\$10 to \$15 million.....	4
\$15 to \$25 million.....	7
\$25 to \$50 million.....	6
Over \$50 million.....	2
Total	44

Continental's domestic telephone subsidiaries are regulated by state public utility commissions with respect to rates for local exchange and intrastate toll service, conditions of service, security deposits, sales and transfers of public utility properties, and adherence to uniform systems of accounts. Five Continental subsidiaries

are subject to the reporting requirements of the FCC. All of Continental's operating companies concur in the interstate tariffs filed by the Bell System with the FCC.

B. Accounting and recordkeeping

Continental follows the accounting and reporting requirements prescribed by the state regulatory agencies in the forty states in which it operates. The various state rules and regulations are consistent in all material respects with the accounting presently prescribed by the FCC for telephone companies, and with generally accepted accounting principles.

The Company's accounting, customer billing and management information systems are centralized at three accounting-data processing centers located in Virginia, Missouri and California. At each of these centers, separate computer-based systems are maintained for the general accounting, property accounting, customer accounting, accounts payable and payroll functions. These systems interact to produce financial statements, operating reports, regulatory reports, and tax and other accounting data reports. The data centers also handle certain specialized functions including construction management, financial planning and time-shared computer services. Continental does not maintain a fully-integrated data base.

Continental collects its source data for accounting functions from local operating areas. Timesheets, material records, payrolls, invoices, customer service orders, and other source documents are transmitted from 234 local business offices to the three centralized accounting-data processing centers where customer bills are prepared, invoices and payrolls are paid and the required records are maintained.

III. COMMENTS

A. Continental's overall assessment of the FCC's USOA proposal

1. Continental Agrees that the Present USOA Does Not Adequately Meet Regulatory and Management Needs and that a New System is Required to Provide Data and Information Demanded by Today's Competitive Environment.

Continental agrees with the Commission that the USOA, as presently structured, "does not provide the industry with an effective tool for managing its resources in the current multi-service environment, or the Commission with the type of information that is necessary to regulate an increasingly complex telecommunications industry." (Notice, ¶5). In particular, today's competitive environment calls for cost, investment and revenue data that will enable management to make proper decisions concerning the continued provision and pricing of competitive service offerings. Detailed information is also essential to regulators who must determine whether service rates are just and reasonable, and whether any unwarranted cross-subsidization exists between service categories. The present USOA, by itself, does not have the flexibility to meet these modern management and regulatory objectives.

Additionally, Continental agrees with the Commission that a modern accounting and information system is necessary to generate data required for effective management and regulation on an ongoing basis without resort to costly and time consuming "special studies." By itself, the present USOA is not up to the task. For example, in carrying out its management functions, Continental often requires plant investment information that was not envisioned when the present USOA was adopted. Refinements and improvements in information collection, processing and reporting must be developed and implemented so that management and regulators can have the necessary data to make decisions on a timely basis. The introduction of competition in the telephone industry and rapidly changing new technologies makes it particularly important that information be available so that decisionmakers can take timely action in light of these developments.

In sum, Continental fully supports the Commission's objectives to develop a revised accounting and information system that will facilitate the preparation of financial reports, serve as a foundation for managerial decisionmaking, provide both management and regulatory bodies with disaggregated cost and revenue information, facilitate the jurisdictional separation process, permit analysis of facility utilization including review of service quality and efficiency, and allow for regulatory and independent auditing. (See Notice, ¶ 12). However, Continental finds serious problems with the methods proposed by the Commission to achieve these goals. Accordingly, Continental's remaining comments will discuss the major deficiencies of the Commission's revised USOA and will suggest an alternative accounting and information system designed to meet the above-stated objectives without the shortcomings of the Commission's proposal.

2. The Commission's Proposed USOA is Unnecessarily Complex and Fails to Consider the Resources and Regulatory Environment of Independent Telephone Companies.

The Commission makes clear that its proposal is directed toward the regulation of the Bell System companies and not to the particular regulatory needs, resources and circumstances of smaller independent carriers. Thus, its Notice emphasizes that the Commission's decision in Docket No. 18128¹—concerning the lawfulness of the rate levels of AT&T's interstate services—requires the furnishing of certain data in order for the Commission to determine whether the rates and rate levels for individual categories or subcategories of service are just, reasonable and non-discriminatory (See Notice, ¶¶ 6-7). The Commission's Notice also stresses that it must have accurate knowledge of the cost of providing service to meet its statutory obligations under the Communications Act and that revenue and cost data should be broken down by both regulatory jurisdiction and individual service category (Notice, ¶ 6). While the Commission's regulatory obligations, as they evolved in Docket No. 18128 and other proceedings, will obviously play a major role in the formulation of a revised carrier accounting and information system, the Commission must be sensitive to other relevant factors in this rulemaking proceeding. Simply stated, the Commission cannot focus *solely* on its regulation of the Bell System in determining whether its proposed USOA is in the public interest.

Although the Commission recognizes that its proposal might be burdensome to smaller telephone companies (Notice ¶¶ 61-62), its Notice shows no real awareness of the particular problems and needs of independent carriers. Most importantly, the Commission fails to recognize certain substantial differences between the operations of Bell System subsidiaries and independent telephone carriers. Due to low subscriber densities, Continental and other independents incur high investment and operating costs to provide "basic" telephone service to rural communities. Moreover, the independent industry faces strong customer demand and state regulatory pressure to convert from multi-party to single-party service. This necessitates additional costly investment in distribution and switching facilities not required by the more urbanized Bell companies.

As the cost of providing basic telephone service in rural areas has increased, Continental has been pressured by many segments of the communities it serves to hold the line on rates. As a result, Continental has found it difficult to implement the cost-of-service pricing policies which the Commission's proposed USOA is designed to facilitate. For example, in 1975 a Continental operating company applied to a state public service commission for a rate increase. The proposed rate structure tempered traditional value of service pricing methods with cost-of-service considerations, thus creating certain changes in the average rate structure to which subscribers were accustomed. Although this effort to introduce cost of service pricing was a very limited first step, there was intense public opposition to the rates. Customers directed political pressure at the company to force it to revise its rate structure. Additionally, the Rural Electrification Administration, reacting to the rate differentials occasioned by the higher cost of providing rural service, declared that construction funds to the company would be discontinued unless it removed the differentials. As a consequence, the subsidiary filed an application requesting the state public service commission for a rate realignment along more traditional value-of-service lines.

Of course, the fact that Continental and other independents, serving largely rural areas, are subject to different problems and regulatory environments does not obviate the need for an accounting and information system that will enable the FCC to carry out its regulatory functions and facilitate managerial decisionmaking under increased industry competition. However, in choosing the means to reach the desired objectives, the FCC must consider the impact on smaller companies. Additionally, the Commission must consider various other factors such as the relatively small number of employees and customers of a typical independent company, its low density service area, its lower level of construction activity, and its smaller volume of various transactions including service order and voucher processing. Consideration of these factors is particularly important in light of the Commission's recognition that state regulatory bodies routinely adopt the FCC's accounting rules as their own and that, therefore, "intrastate companies not directly subject to the Commission's jurisdiction may be affected." (Notice, ¶ 61). Moreover, because of their smaller size, the higher cost of providing rural service, and the need to keep local exchange service rates as low as possible, many independents will find it exceedingly difficult either to absorb or pass through to subscribers the additional expense

¹ *AT&T Private Line Services*, 61 F.C.C. 2d 587 (1976).

occasioned by the Commission's proposal. In short, compliance with the Commission's proposal may be impossible for many independent telephone companies.

This conclusion is apparent when viewed in light of the additional costs that will be imposed on the small telephone company by the Commission's proposal. First, substantial costs will be entailed in developing a data processing system sufficient to implement the Commission's concept of an integrated data base capable of random access to financial and non-financial data. As noted above, Continental does not maintain an integrated data base, although it maintains several sophisticated computer systems for its operating companies. Despite its present data processing capabilities, Continental estimates that it could cost as much as \$25 million to convert to an integrated data base system as proposed by the Commission. Conversion to such a system would require large expenditures for additional computer hardware, software, programming support, employees and related costs. Independents that do not presently enjoy the data processing capabilities of Continental could incur even higher costs depending on their size and existing computer configuration.

Unfortunately, increased computer costs are only the tip of the iceberg. The Commission erroneously states that its proposals on plant accounting and expense records should necessitate but minimal retraining of rank and file employees, and even of managers. Most of the detail that must be recorded and assignments and allocations that must be made will be done within the computer by correlating various types of information that presently exist but do not now enter the system. (Notice, ¶60).

Contrary to the Commission's belief, the information necessary for the detailed reporting required by the Commission's proposal does not "presently exist." Such information must be gathered at the source level (*e.g.*, where the data can be identified for the first time, such as from a work order) on a continuing basis. This will require sophisticated training for most craft and clerical employees who will have to master the intricate details required by the Commission's proposed accounts. Additional costs will be incurred as productivity drops while employees carry out their source reporting functions.

The cost burden of the Commission's proposal will be particularly severe for smaller companies that lack the specialized work forces of the large carriers such as Bell. For example, a craft employee who functions as a cable splicer and installer for a small telephone company will need to know more reporting details than one who functions solely as a cable splicer for a larger company. Thus, smaller companies will not only incur higher training costs per employee than larger companies, they will also be forced to add employees to compensate for the greater loss of on-line productivity as the Commission's complex reporting requirements interfere with primary work functions. Moreover, attempts to facilitate data reporting by restructuring work functions along the specialized lines of the larger companies could result in the loss of certain operating efficiencies enjoyed by smaller companies. Accordingly, the Commission's proposal will, on a relative basis, impact most severely on the smaller, independent telephone carrier.²

Many of Continental's operating subsidiaries will experience the severe cost burdens imposed by the Commission's reporting requirements. Continental is a large company only if viewed on a combined basis. While the size of its telephone operating subsidiaries varies from state to state, most of these companies are quite small. The above described costs of employee training and staffing are directly related to the size of the operating company and not to the size of the combined system since the source data gathering and reporting functions must be carried out at the operating company level. Accordingly, Continental's units will incur the same training and staffing costs as similar sized independents that are not system affiliated. These costs could put strong upward pressure on the level of rates in the rural areas served by these smaller Continental subsidiaries.

In sum, the most serious deficiency of the Commission's revised USOA is that it does not take into consideration the burdensome impact on independent telephone companies, particularly the smaller carriers serving largely rural areas where costs are already high due to low subscriber densities. The Commission fails to recognize that these companies and their subscribers will bear a proportionately greater burden, as compared to larger companies, of the additional costs necessitated by the

²The Commission's suggestion that its proposed system of accounts may apply only to carriers with over \$1,000,000 in annual operating revenues (Notice, ¶62), will do little to alleviate the burden on the small carrier. \$1 million in operating revenues equates to a company with only 3,500 to 4,000 subscribers, on the average. A company of this size would generally have 15 to 20 employees. Obviously, a carrier even 4 to 5 times larger would still be relatively small. Such a carrier would find prohibitive the costs of implementing and maintaining the required sophisticated data processing, as well as the training costs and decreases in worker productivity which would result from the Commission's proposal.

Commission's proposal. Before turning to Continental's alternative proposal, several other comments on the Commission's revised system of accounts deserve mention.

3. Implementation of the Commission's Revised USOA is Impossible Within the Proposed Time Schedule.

The Commission's time schedule for implementing its proposal (Notice, ¶ 46) fails to reflect the complexity of the revised USOA. Implementation of the Commission's proposal, or any new comprehensive accounting and information system, could take as long as 10 to 15 years. As previously noted, much of the data required by the Commission does not presently exist. Compilation of this data takes time. For example, many of the companies which were merged into the Continental System were Class C carriers that were not required to keep detailed plant records. Since acquiring these companies, Continental has been updating its record system to provide more detailed reporting. At present, Continental is developing a unit property system for its own management use. Continental has conservatively estimated that up to ten years will be required in order to convert the present plant and investment records to the unit property system. All plant must be physically inventoried and each individual plant item must be related to book costs. Continental notes that its unit property system is not as detailed as the Commission's proposal.

In addition to the time needed to bring historical records into compliance with a new reporting system, Continental has found that it takes up to three years to design, develop, program and implement a new computer-based system, such as the one Continental is implementing for construction management purposes. A more comprehensive computer-based system, such as proposed by the Commission, would take considerably longer to implement.

4. The Commission Overestimates the Usefulness of its Proposal to Telephone Company Management.

The detail specified by the Commission goes far beyond the needs of management. While disaggregated cost and revenue information is important for management decision-making, particularly in a competitive environment, the minute accounting detail in the proposed USOA serves no useful management purpose. As discussed below, management requirements can be accommodated with cost data displayed at a higher aggregation level than set forth in the Commission's Notice.

Along these same lines, it appears that the Commission is misinformed as to management's use of cost data in investment decisions. Thus, the Commission states that the revised USOA will facilitate its review of the economic rationality of investments in plant and equipment (Notice, ¶ 32). Implied in the Commission's statement is that the fully distributed costing procedures to be reflected in the revised USOA are instrumental in making investment decisions.

While fully distributed costs serve as the benchmark for determining lawful rates—at least before the FCC—they are largely irrelevant to managerial investment decisions. As public utilities, the telephone industry is often obligated to provide service where the required investment is not cost justified under an FDC analysis. When telephone engineers are confronted with a requirement to accommodate a particular service need, their selection among available alternatives is based upon the investment approach that will be the most beneficial (or at least damaging) to the business on an incremental basis. Fully distributed costs play no role in determining the attractiveness of the selected investment plan relative to other alternatives. Accordingly, the investment cost break-out specified in the Commission's proposal is superfluous to an evaluation of the investment decision process.

5. The Proposed System of Accounts is Subject to Substantial Errors in the Data Reporting Process.

As discussed above, under the Commission's proposal craft and clerical personnel will be required to classify plant investment and costs, including their own time, in the detailed manner prescribed by the revised USOA.³ Continental's experience in gathering detailed information at the source level leads it to conclude that the FCC's proposed reporting requirements will be subject to substantial errors. For example, many Continental craft employees work in remote locations as "combination men", with minimum supervision. Such employees often must accomplish all facets of the installation-repair function, in addition to central office maintenance and cable splicing tasks. In this light, it is easy to understand why it would be difficult to attain a high degree to accuracy in data reporting. The decisions faced by these employees in the course of filling out their time sheets and other reporting

³ While employees often classify their work time by function performed (e.g., splicing, driving), this is a far cry from having craft and clerical employees decide what particular services received benefit of their labor.

documents simply becomes too difficult. As a result the process itself becomes unmanageable. Considering the importance that the Commission places on the information to be generated by its proposed system of accounts, it is anomalous that the burden of making the most significant decisions is shifted to the craft employee.

6. The FCC's Proposal Will Not Eliminate Special Studies.

Contrary to the Commission's intent (Notice, ¶13), its proposal will not completely eliminate costly and time-consuming special studies. Additionally, an ongoing requirement of accumulating and retaining enormous quantities of detailed information in computer files, writing special programs for the manipulation of those files, and utilizing expensive computer processing time will be substituted for the previously occasional effort of gathering data and producing the required studies. Moreover, computer studies are limited to data existing in the data bases. Thus, future studies requiring data whose inclusion is unforeseen at this time will still require individual manual preparation.

The Commission requires that "[a]ll criticism [of its proposal] should be accompanied by counterproposals that are demonstrated to produce fully equivalent information with less cost, or even better and more relevant information at the same cost." (Notice, ¶ 24). Over the past several months, Continental has devoted substantial staff resources to formulating an accounting and data reporting system that will accomplish the Commission's objectives and eliminate, or at least minimize, the costs and problems inherent in the Commission's proposal. The following proposal is the result of these efforts. Although it is not complete in every detail, Continental believes that its proposal provides a useful framework for the development of a comprehensive system, perhaps through informal discussions between Commission staff and interested parties. After outlining its proposal, Continental will discuss further problems and comments raised by the Commission's Notice.

B. Continental's Proposal and Detailed Comments

1. Continental's Proposal Provides for (i) Less Costly and More Accurate Data Reporting and (ii) an Allocation of Revenues, Expenses and Investments to the Various Service Categories.

(a) *Overview.*—Central to Continental's proposal is the recognition that today telephone carriers provide multiple services that can be considered either as (i) regulated monopoly, such as basic local services and, at present, a substantial portion of intercity communications; or (ii) regulated competition, such as competition between regulated carriers and non-carrier companies for the sale or lease of terminal equipment, and competition between the established carriers and the specialized carriers for high density intercity routes. Additionally, Continental foresees the complete deregulation of certain markets—such as terminal equipment—as federal and state regulatory dockets examine the myriad issues by the growing competitive environment.

In line with these prospects, Continental believes that an accounting and information system should track four distinct markets, or "business segments", that reflect the evolving distinctions in the competitive structure of the telephone industry. These business segments include terminal equipment, subscriber premise installations, local distribution and intercity services. Under Continental's proposal, revenue, expense and investment data will be assigned or allocated directly to the four business segments rather than to the detailed accounts and subaccounts contained in the Commission's revised USOA. Reporting of source level data to the four business markets will provide a natural grouping of costs for managerial decision-making, will reduce significantly the cost associated with information gathering, and will result in a higher degree of accuracy since craft and clerical personnel will not be required to make complex decisions regarding cost incidence. Once the data is classified by business segment, allocation procedures will assign costs and revenues to the appropriate services consistent with prescribed Commission ratemaking methodologies.

Continental recognizes that a revised USOA, if it is to be used by both federal and state regulatory authorities, cannot reflect particular ratemaking philosophies. Accordingly, Continental's proposal maintains the service allocation procedures independent of the general ledger accounts. This will allow the allocation procedures to be modified as ratemaking methodologies change, without restructuring the underlying accounts.

(b) *The Four Business Segments.*—As noted above, Continental proposes to assign or allocate source level data directly to four business segments that demark broad markets within the telephone industry. The first business segment, terminal equipment, includes the leasing and sale of station equipment—such as PBX's, handsets

and modems—to business and residential customers. Today, the terminal equipment market is characterized by intense competition between regulated common carriers and nonregulated equipment distributors. As such, Continental foresees the eventual deregulation of this market at both federal and state levels, excepting technical standards. It logically follows that accounting and data reporting for this market must be segregated. Separate accounting for the terminal equipment market will facilitate management decisions whether to continue or discontinue the supply of terminal equipment and whether to sell or lease such equipment. The break out of terminal equipment as a broad market segment will also enable regulators to determine whether this market is being cross-subsidized by other business activities.

Subscriber premise installations comprise the second business segment under Continental's proposal. This market includes inside subscriber premise wiring and installation costs associated with terminal equipment. Although traditionally considered part of the same market as terminal equipment, subscriber premise installation is emerging as a distinct market and is slowly being opened to competitive supply. As with the terminal equipment market, it follows that accounting and data reporting relating to subscriber premise installations must be segregated to permit proper management and regulation of this segment of the telephone industry.

The third major business segment under Continental's proposed accounting system is local distribution which includes local exchange switching, access lines and private line local channels. Presently, local distribution is regulated as a monopoly. It is a telephone market where concepts such as contribution, value-of-service and rate averaging continue to be important factors in the ratemaking process. Local distribution requires separate accounting and data reporting to facilitate compliance with federal and state jurisdictional regulatory requirements and to permit a tracking of costs for managerial purposes.

Intercity services are the fourth major business segment. This market includes the provision of message toll and WATS service over the nationwide switched network, as well as intercity private line services. Approximately 90 percent of Continental's revenues from this business segment is derived from toll settlements with the Bell system companies.

Today specialized carriers are providing competitive private line services within the intercity business segment as well as certain types of switched services such as Execunet. Moreover, the Commission is presently studying the question of whether to permit competition in all areas of the intercity market.⁴ Given the distinct activities performed by this business segment and the evolving competitive environment, this portion of the telephone industry should be accounted for and reported as a separate market. Additionally, separate treatment of this market is justified by the FCC's primary concern with the regulation of intercity services. This segregation will enable the Commission to monitor contributions between the intercity market and the three other business segments.

The four business segments alone provide a level of data disaggregation that should prove valuable to both management and regulatory decisionmaking, especially in light of the emerging competitive structure of the industry. However, Continental realizes that a break out of accounting data by individual service category is also important to meet the Commission's regulatory objectives. Accordingly, as discussed in greater detail below, Continental's proposal provides for an allocation of costs, revenues and investment to the separate services.

(c) *Data Reporting.*—Continental's proposal simplifies data reporting at the craft and clerical source level since expense and investment items will be classified by work function rather than being reported to detailed service based accounts as proposed by the Commission. A work function is a description of the task performed, such as cable splicing and installation, or type of plant. Time sheets, work orders and other source documents will contain the work function so as to allow assignment or allocation of accounting data to one of the four major markets. For example, costs of toll operator functions would be reflected in the intercity services business segment. Under the functional approach, telephone companies with even minimum data processing capabilities should be able to computerize the classification of data by business segments in the processing of source level documents. However, manual assignment to business segments should not be burdensome for those small carriers which lack computer facilities.

The work function data will also be summarized in the general ledger accounts. Since the business segment classification will not be reflected in the general ledger, modifications can be made to the data accumulated within the four segments without disturbing the accounts. Such data revisions, or even a partial restructuring

⁴ See *MTS and WATS Market Structure*, Notice of Inquiry and Proposed Rule Making, FCC 78-144, released March 3, 1978.

of the business segments themselves, might be required by changes in the competitive structure of the industry or by the needs of management or regulatory bodies.

(d) *Changes in the General Ledger Accounts.*—In the broadest sense, Continental proposes general ledger accounts similar to the present USOA in order to facilitate accounting and performance comparisons between all time periods. However, Continental does propose the following changes in the structure of the general ledger plant accounts:

1. Separate circuit equipment, including radio, from switching equipment in order to reflect different depreciation lives and functions performed.

2. Realign the station apparatus and large PBX accounts to distinguish between individual instruments and terminals (which are best suited to cradle-to-grave accounting without maintaining unit location information in the property record), and equipment assemblies such as large and small PBX/PABX, key systems, centrex installations, and automatic call distributors (which are best handled by a work order system with location information maintained in the property record).

3. Distinguish between inside wiring and the drop for station connections. This will reflect changes in state regulatory policies concerning subscriber ownership of inside wiring.

4. Establish a distinct general ledger account for general purpose computers and data processing equipment in order to recognize different functions and service lives for computers as compared to furniture and fixtures.

(e) *Assignment and Allocation of Costs.*—An important characteristic of data reporting to the four business segments is that certain costs and investments can be assigned directly to a particular business segment, while "common" costs and investments must be allocated. In addition to maintenance and depreciation, examples of costs that can be directly assigned to a particular business segment include (1) for the terminal equipment business segment: subscriber training, equipment advertising, and equipment marketing; (2) for the subscriber premise installation business segment: engineering and labor directly related to equipment installation and the cost of inside wiring; (3) for the local distribution business segment: local information, local traffic monitoring, local engineering and test desk work-local; and (4) for the intercity services business segment: toll traffic operator costs, network engineering and test desk work-intercity.

Certain costs and plant investment will have to be allocated among the four business segments since they are incurred on a common, or shared, basis. As the FCC recognizes (Notice, ¶¶ 29-30), some common costs can be directly allocated based on actual plant usage, labor rates, and other direct causation factors. Such directly allocable costs include house service, vehicle expense, and plant supervision. However, other common costs are considered unallocable by any direct basis. These costs include, among others, taxes, interest and general department expenses. Continental proposes that these costs be attributed to the four business segments on the same basis as they are allocated by the FDC manual to the particular services, i.e., by the use of several proportional measures such as related book costs, wages or total attributed annual costs.

Continental's proposed system will directly assign revenues to the various services without accumulating the disaggregated information in the general ledger. Continental already accumulates on a regular basis a breakdown of local service revenues. Individual service revenues can be directly obtained from the 3 other major business markets, except that adjustments will have to be made to intercity service revenues to account for the toll settlement process. Under Continental's proposal, uncollectible operating revenues would be accounted for on a company-wide basis, but could be allocated to individual services if necessary for ratemaking purposes.

At this stage under Continental's proposed system, there exist general ledger accounts and a reporting of costs, revenues and investments to the four business segments of the telephone industry. Continental believes that its business segment approach will suffice for most management needs and for many regulatory purposes. However, Continental realizes that in order for the FCC to fulfill its regulatory objectives, it requires disaggregated costs, revenues and investment for each of the major categories of telephone service. Accordingly, Continental's proposal incorporates service allocation procedures to achieve the desired level of accounting disaggregation.

(f) *Service Allocation Procedures.*—Once accounting data is assigned and allocated to the four business segments, service by service disaggregation can be accomplished by allocation procedures. To meet the requirements of the FCC and state regulatory bodies and to achieve industry consistency, Continental proposes that these service allocation procedures be established and implemented through informal meetings between industry representatives and staff members of the FCC and state commissions. The service allocation procedures will reflect the Commission's prescribed

FDC methodologies. Since the service allocation procedures will be independent of the general ledger accounts, and even the structure of the four business segments, future changes in costing methodologies can be easily implemented. Additionally, state regulatory authorities can adopt variations of the service allocation procedures to their particular needs.

Continental envisions that it will be able to computerize the service allocation procedures with its existing hardware capabilities by using additional software and program support. Although such computerization will be expensive, it will be far less costly than the onerous data processing required by the Commission's proposal. Telephone companies lacking the necessary computer facilities will be able to implement the service allocation procedures on a manual basis.

With the establishment of service allocation procedures the Commission will be able to trace service costs back through the data processing stage to the source level input. The service allocation procedures will allow for the integration of financial and non-financial data into fully distributed cost of service reporting. Under this approach, service cost information would be readily available, without the need to initiate studies, for evaluating tariff filings, for regulatory surveillance of carrier performance and for ensuring carrier accountability.

(g) *Maintenance of a Data Base.*—As noted above, the Continental System does not maintain an integrated data base. Rather, it is served by separate data processing centers in each of its three operating regions. Continental efficiently utilizes its computers and programming staff on a functional basis—data processing for certain company-wide functions, such as construction management or financial planning, is accomplished at a single data center. The three data centers are interconnected and are able to communicate the results of their individual functional processing to each other for further processing when necessary.

As a result of its experience with functional processing, Continental's proposed accounting and information system will be supported by multiple, interconnected data bases. Such an arrangement will meet the Commission's objective of accumulating, and having ready access to, financial and non-financial data for regulatory purposes. Further, a multiple data base system will have the capability of generating, through variable data access, the annual auditing tape described in paragraph 57 of the Commission's Notice. This tape would include balance sheet and income statement items, primary allocation records and costs allocated by individual service categories.

(h) *Advantages of Continental's Proposed System.*—In sum, Continental's proposed accounting and data reporting system offers the following advantages:

1. It meets the seven objectives outlined in the Commission's Notice, ¶ 12.
2. It eliminates detailed source level reporting of data, thereby saving costs, facilitating efficient employee utilization and ensuring a high level of data accuracy.
3. Reporting of data directly to four business segments allows for a level of analysis that is sufficient for most managerial and many regulatory purposes. More detailed analysis can be achieved through the service allocation procedures.
4. The business segment approach and service allocation procedures provide flexibility to account for changes in market structure, technology and rate-making methodologies.
5. Since the reporting of data by business segment and service category is independent of the general ledger accounts, changes in assignments and allocation procedures will not affect the structure or content of the ledger accounts.

* * * * *

The remainder of Continental's comments discuss various issues raised by the Commission's Notice and how these issues would be addressed under Continental's proposal.

2. The Commission's Proposal to Integrate the Revised USOA With the Reconciliation and Waiver Process Will Create Serious Accounting Problems.

Continental recognizes that in light of the ratemaking methodologies established in Docket No. 18128, reassignment of plant between services may be necessary when FDC method 1 analysis indicates a disparity between actual and forecasted plant usage (See Notice ¶¶ 35, 41). Under the Commission's proposal, such reconciliation will be accomplished by Commission ordered "accounting changes and transfers" (Notice, ¶ 35). Continental submits that reconciliation of forecasted and actual usage by changing the general ledger accounts, as proposed by the Commission, conflicts with fundamental accounting principles.

Once accounting data, including plant investment is reported to general ledger accounts, adjustments to the accounts, except when required by generally accepted

accounting principals, serve only to create inconsistencies between reporting periods. Such inconsistencies could cause misstatements in monthly and quarterly management and investor reports. To prevent such reporting misstatements, management and financial reports would have to be adjusted on a continual basis to account for FCC ordered reassignments. As time progresses, the task will become unmanageable. The underlying accounts will differ from the reports to such a substantial degree that both internal and external auditing of these reports and accounts will become impossible.

Under Continental's proposal, the reconciliation between forecasted and actual usage will take place through revisions to the computer program performing the service allocation procedures. Since this program will be completely independent of the general ledger accounts, time period consistency would not be a problem and the stability and integrity of the financial accounting system would be maintained. The necessary adjustments can be made where the allocation procedures are performed on a manual basis.

Moreover, Continental's system will provide greater flexibility than the FCC's proposal. Under the Commission's revised USOA, the primary allocation record will contain the assignment of costs and plant investment to a particular service. Because of the great number of these records—a primary allocation record will exist for each operating expense and plant subaccount by primary recordation location—reassignment will be inordinately cumbersome.⁵ Each record will have to be modified individually. Continental would perform the plant reassignments within its service allocation procedures program by having the primary allocation record refer to a function stored in an allocation table within the program. Reassignment would be accomplished by changing the allocation table with a programming modification and then reapplying the table to the service allocation data base. This would greatly simplify the reconciliation process.

Along these same lines, the Commission requests comments concerning the precise point at which service assignment should be made and accounting records established to fix cost incidence (Notice, ¶ 34). The FCC is particularly concerned with fungible plant; that is, plant which after it is in place can be put to a "myriad of uses". Continental proposes to establish allocation records at the time of issuance of the specific work order, since this is the earliest time at which meaningful allocations can be made. Work orders would be coded to fix cost incidence. The coded data would be reflected in the allocation table contained in the service allocation procedures program.

As the Commission recognizes (Notice, ¶ 34), the point at which cost incidence is fixed will vary from project to project depending on the type of construction and degree of planning. Thus, work orders for engineered projects requiring long lead times for planning and ordering supplies, such as central office projects, might be issued two years ahead of schedule. Work orders for small outside plant projects, where materials are on hand, might be issued only a few days before construction.

3. Proper Depreciation Practices Require That the Commission Not Completely Abandon the Present Structure of Plant Accounts.

As discussed above, Continental proposes general ledger accounts structured in a fashion similar to the present USOA. Continental believes that it is particularly important to preserve the present structure of plant accounts, rather than restructuring them as the Commission proposes (Notice, ¶ 16). Continental notes that the present plant account structure represents a sensible grouping of like units. Under the proposed USOA, like units would be spread among several primary accounts and the benefits of like unit depreciation would be lost.

Moreover, proper depreciation analysis demands that historical mortality information be available for the grouping of like retirement units which share a common probability of retirement by age. Additionally, regulatory authorities require that each company maintain a physical inventory of plant in a manner which will facilitate depreciation studies, auditing and verification. The present structure of plant accounts can more readily meet these needs than the proposed USOA.

Several other comments on depreciation are relevant at this point. The Commission invites discussion (Notice, ¶ 14, n. 11) as to what additional information would be required for implementing equal life group ("ELG") depreciation. Continental does not view the adoption of ELG depreciation as a problem within the context of

⁵ Under the Commission's proposal, Continental estimates that 10 million items of its property might be recorded in an integrated data base. Approximately 30 percent of this total or 3,000,000 items, would be for Continental companies reporting to the FCC. Assuming that only 10 percent of these property units were reassigned during a year and that only one-fourth of such reassignments would produce a change significant to warrant reconciliation, a potential 75,000 requests to the Commission would be produced under the reconciliation process.

its proposal. Since Continental's unit property record captures and maintains vintage investment data, Continental can easily accommodate ELG depreciation within its present mechanized accounting system. Additionally, Continental's system has the capability to carry accrued reserve by vintage if necessary to implement ELG depreciation. A revised USOA can accommodate ELG depreciation so long as the identity of vintage investment in depreciable plant units is not obscured.

The Commission invites comments concerning the usefulness of retirement units in ratemaking (Notice, ¶ 43). Continental agrees that retirement units are not useful for ratemaking purposes but are essential to properly account for plant investment. Continental submits that the retirement unit offers the most manageable points to allocate plant to specific markets and services, to apply depreciation accrual and to track reserve. This may involve the investment in individual retirement units (the extreme case), or it may involve the investment associated with groupings of like retirement units, by vintage, within the primary recordation location. Continental believes that the use of retirement units to generate and track depreciation does not impose any constraints concerning the recording of maintenance expense as implied by the Commission (See Notice, ¶ 43).

4. Adequate Treatment of Plant Under Construction Does Not Require Two Separate Accounts, or Subaccounts at the Same Level of Detail as Plant in Service.

The Commission proposes to establish separate accounts for plant under construction ("PUC") intended to be placed in service within one year, and PUC not intended to be placed in service within one year. The Commission also proposes subaccounts for PUC at the same level of detail as plant in service (Notice, ¶ 44).

Continental believes that both of these proposals are unnecessary and serve only to further complicate the USOA. If each work order carried the anticipated "in-service-date" it could be entered into the data system. At any point in time, the data system could summarize the incurred work order costs that would be placed in service within one year and those to be placed in service after one year. The fact that such a breakdown might be useful for ratemaking purposes does not require it to be reflected in the general ledger accounts.

With respect to recording PUC at the same level of detail as plant in service, Continental submits that this is not required for the allocation of PUC to specific services. Under Continental's proposal, work order costs will be directly assigned to the four business segments. The work order data entered into the accounting and information system will include service assignment records which will enable PUC to be allocated to individual services as required for management or regulatory purposes. Continental believes that this analysis of related current work orders is a more manageable and efficient method than an ongoing requirement of maintaining the level of detail proposed by the FCC for PUC within the general ledger accounts.

For the same reasons, Continental feels that separate accounts are not needed for property held for future use ("PHFFU") intended to be placed in service within one year and PHFFU intended to be placed in service after one year (Notice, ¶ 44). Likewise, PHFFU should not be reported with the same level of detail as plant in service. With respect to facilities available for future growth ("FAFFG"), Continental sees no need to establish special plant subaccounts (Notice, ¶ 44). FAFFG can be measured and audited through existing records. If necessary for rulemaking purposes, FAFFG can be allocated to the various services by means of the service allocation procedures.

5. The Use of Separate Accounts For "Common" and "Fungible" Plant Would Be Unduly Confusing.

The Commission invites comments concerning its definition and use of the terms "common" and "fungible". Specifically, the Commission asks whether it is necessary to use both accounts or whether such use would prove to be unduly confusing, and whether all plant should be assigned to service based accounts at installation (Notice, ¶ 21).

Continental does not object to the Commission's definition of the terms "common" and "fungible". However, Continental feels that any item of plant that is not assignable to a single account or subaccount should be classified as "common" with the allocation of the plant noted in the continuing property records ("CPR") contained in the accounting and information system. Under Continental's proposal, changes in plant allocation would be reflected in the CPR and thereby in the allocation among the four business segments.

So-called "fungible" plant need not be treated differently. If there is a change in the assignment of fungible plant this will also be reflected in the CPR. Accordingly, the distinction between "common" and "fungible" is not useful and, as suggested in the Notice, will be unduly confusing. Additionally, Continental does not feel that there should be a category for "other" plant as proposed by the Commission. An

"other" plant category is not required by a system of plant accounts based on groupings of like retirement units.

The Commission's question as to whether all plant should be assigned to service based accounts at installation (Notice, ¶ 21), suggests that where plant is common to more than one service, its investment will be split among these services at the time it is recorded on the books. Continental believes that such splitting of investment in one retirement unit among different plant accounts would be totally unmanageable. Accordingly, plant units which are common to two or more services should be recorded as "common" and assigned to the various services by the allocation process.

6. The FCC's Proposed Treatment of Maintenance Expense Is Unnecessarily Complicated and Is Susceptible to Errors in Service Attribution.

The FCC states that "most maintenance is directly assignable to service. All maintenance expense is directly assignable to plant, thereby providing a basis for allocation of those elements of maintenance which were not directly assigned. Even so, an allocation record for maintenance expense is necessary for proper allocation, and regulatory and management control of such expenditures." (Notice, Appendix E).

Continental submits that maintenance allocation to services should follow the maintained plant which is the primary recordation location for maintenance. If, as the FCC suggests, a separate primary allocation record is used, maintenance might be charged to services that it is not supporting. If a particular allocation to service is proper for the investment, then the allocation must be proper for the maintenance of that same investment; therefore, the same allocation record should be used to avoid errors in service attribution. Although a maintenance primary allocation record could be used to accumulate hours, budget and other relevant data for the maintenance subaccount, allocation of maintenance to services should track allocation of plant.

Under Continental's proposal, maintenance charges would be accumulated in the four basic business segments. This level of information would be adequate for management control of the maintenance function and most regulatory purposes. When required for FCC ratemaking, maintenance expenses could be attributed to the various services by means of the service allocation procedures.

IV. CONCLUSION

By initiating this proceeding the Commission has taken an important first step in the development of an improved accounting and information system for the telephone industry designed for today's competitive environment. However, any new system should reflect not only the Commission's regulatory objectives, but also the resources, management needs and regulatory concerns of the independent telephone industry. In this respect, the Commission's proposal is seriously deficient.

Continental urges the Commission to give careful consideration to its alternative proposal. Continental's accounting and information system will provide the detailed disaggregated cost and revenue information necessary for managerial decisions and effective regulation. Unlike the Commission's revised USOA, Continental's proposal can be effectively implemented at lower cost and without sophisticated computer hardware. Moreover, Continental's system provides flexibility to meet future changes in management and regulatory requirements while maintaining the stability and integrity of the general ledger accounts.

Although its proposal provides a framework for a practicable accounting and information system, Continental recognizes that development and implementation of a system with the desired characteristics cannot be accomplished overnight. Additional comments most likely will be necessary to crystallize essential concepts. Additional meetings between Commission staff, industry representatives and other interested parties will be required to ensure that these concepts are reflected in the prescribed system. Only through such an ongoing process can the industry, the Commission and the State regulatory authorities, obtain an accounting and information system that will adequately serve their needs in the years to come. Continental looks forward to working with the Commission in this endeavor.

CONTINENTAL'S COMMENTS ON SPECIFIC QUESTIONS RAISED BY THE COMMISSION'S NOTICE

Question 1. (Notice, ¶ 42) The Commission invites comments on the use of functional expense accounts in its revised USOA.

Comment. Continental agrees with the Commission that expense accounting is facilitated by a functional approach; however, contrary to the Commission state-

ment, the present USOA is not restricted along organizational lines. Continental analyzes activities and charges by function and records them to the proper account within the present USOA. The accounting classification is not influenced by the department which gave rise to the expense.

Additionally, Continental disagrees with the Commission's proposal that once the expenses of each operating company are classified by function, "each functional category should, in turn, be divided between the various services." As discussed in detail in Continental's comments, there is no need to classify data by service within the general accounts. Significant cost savings and flexibility are obtained by using service allocation procedures to disaggregate expense accounts by service category.

Question 2. (Notice, ¶ 43) The Commission proposes "that depreciation records be kept for each subaccount at the level of primary recordation of data: The wire center, the transmission span, and possibly the exchange or other administrative area (the primary recordation location)." The Commission further observes that "under the present group plan of depreciation, there can be no such thing as fully depreciated plant." Finally, the Commission argues that "[t]he allocation of the depreciation reserve to primary accounting locations (wire center, transmission span and exchange or administrative area) will not require a high order of record keeping."

Comment. The Commission's statements infer that it proposes to abandon the company wide averaging methods presently employed in depreciation and, instead, contain all depreciation accounting within the bounds of individual primary recordation locations ("PRL's"). Thus, plant may well achieve a "fully depreciated" status under the Commission's proposal.

Under Continental's proposal plant accounts would continue to reflect groupings of like retirement units, with subaccounting used to assign individual plant units to specific PRL's. Because all like retirement units may be considered to share a common probability of retirement by age, Continental believes that it is inappropriate to distort the relative reserves of the several PRL's depending on where a retirement event may actually occur. Therefore, Continental proposes that depreciation accounting should be accomplished at the company level, by plant account, with the resulting end of period reserve allocated to the several PRL's. Thus, the advantage of company wide averaging would be preserved. Depreciation expense for any particular period in any given PRL would be the product of the depreciation rate times the plant investment; however, the end of period reserve will not be the net result of all prior accrual and retirement activity at that location.

Continental notes that the allocation of reserve to the PRL's will require a higher order of record keeping than is suggested by the Commission. Because the reserve associated with plant investment is a function of age and the mortality dispersion experienced by that plant, the investment must be identified by vintage in order to permit proper reserve allocation.

Question 3. (Notice, ¶ 47) The Commission asks the following question: "To what degree should even the broadest engineering characteristics of provision of telecommunications services become an intrinsic part of the logic of the revised USOA?"

Comment. Continental believes that the structure of the revised USOA should not be tied to known technology or to the present configuration of the telephone network. To cast a revised USOA within the mold of present technology would only assure a further major revision of the accounts in the future.

Question 4. (Notice, ¶ 55) The FCC seeks suggestions on how the USOA can be changed so as to provide incentives which would improve carrier efficiency and the quality of regulatory and managerial decisions.

Comment. Continental believes that its proposed system will provide improved information concerning its telephone operations which will facilitate both management decisionmaking and regulatory oversight. Management's ability to make prudent decisions based on accurate information will help Continental to provide its customers a high grade of service at the least possible cost. In contrast, as explained in Continental's comments, the Commission's revised USOA could seriously impair worker productivity and carrier efficiency, especially with respect to smaller telephone companies.

Question 5. (Notice, ¶ 57) The Commission invites comments as to what reporting requirements should be established once the basic USOA revisions are accomplished.

Comment. As stated in Continental's proposal, the Company will provide on an annual basis a magnetic tape which will include the basic balance sheet and income statement, along with primary allocation records and costs allocated by individual service categories. By using the proposed service allocation procedures, Continental will be able to furnish the Commission information concerning the services it provides on an "as needed" basis.

Question 6. (Notice, ¶ 57) The Commission asks "What types of special reports should the system be designed to generate?"

Comment. Continental's proposed system, incorporating business segment reporting and service allocation procedures, has the flexibility to produce reports as required by either management or the Commission. Any accounting and information system should have enough flexibility to respond to new reporting requirements as they arise. For this reason, Continental does not feel that it is necessary to specify types of reports for incorporation into system design.

Question 7. (Notice, ¶ 58) The Commission invites comments on additional structural safeguards which should be built into a revised USOA to further enhance auditing and entry verification in a computer-maintained system.

Comment. Rather than commenting on the obvious internal control mechanisms that all computer systems must contain, Continental urges the use of its proposed service allocation procedures which will be designed to facilitate the auditing and entry verification of information, whether in a computer-based or manual system. By using the procedures, all carriers would allocate costs, revenues, and investment in a similar manner thereby allowing for comparisons among carriers and different time periods.

Question 8. (Notice, ¶ 59) The Commission states: "New and amended rules may also be required because of the changed operating environment resulting from the equipment registration program. Among the specific accounting items that need attention and for which we invite comments are: (1) Accounting for gains and losses on the sale of terminal equipment both new and in-place; (2) accounting for the sale of inside wiring; (3) accounting for the removal of company telephones from customers' premises when customers provide their own equipment; (4) accounting for the repair of customer provided equipment; (5) determination of the cost of equipment to be sold and the repair charges to be imposed—direct costs and overheads; (6) whether these operations will be conducted under tariff; (7) whether operating and non-operating accounting treatment of gains and losses on these transactions is appropriate."

Comment. The following comments are submitted with respect to:

1. Accounting for gains and losses on the sale of terminal equipment both new and in-place.

The terminal equipment market is now characterized by competitive supply and demand. Continental firmly believes that deregulation of this market is necessary if telephone carriers are to remain viable participants. There must be no pricing constraints. With the deregulation of terminal equipment, the utility should not be subject to any specified accounting requirements by the Commission for new equipment purchased, sold or leased after a specified date. All accounting for terminal equipment should be below-the-line or in a non-regulated subsidiary.

With respect to in-place and in-stock terminal equipment acquired prior to the deregulation cutoff date, it must be recognized that telephone companies, as regulated monopolies, made investments in terminal equipment with an understanding that their investment, plus a reasonable return, would be recovered over the life of the investment. With deregulation, telephone companies must be permitted to recoup their embedded investments by marketing the equipment over a reasonable period of time. These sales should be recorded as salvage against the rate base. If after this time period the utility has not recovered its investment in terminal equipment, the remaining net plant should be amortized and recovered as a rate base expense.

2. Accounting for the sale of inside wiring. Continental also supports the deregulation of inside wiring (subscriber premise installations). All income and expense associated with inside wiring should be below-the-line. Since Continental does not believe that current subscribers will purchase in-place wiring, it suggests a reasonable amortization to operating expense of the current embedded investment.

3. Accounting for the removal of company telephones from customers' premises when customers provide their own equipment.

The cost of removal should be accounted for as a reduction in the reserve for depreciation and any terminal equipment returned to inventory should be sold with the resulting net revenues recorded as salvage to the reserve for depreciation.

4. Accounting for the repair of customer provided equipment.

Repairs of customer provided equipment should be deregulated and accounted for by telephone companies on a below-the-line basis.

5. Determination of the cost of equipment to be sold and the repair charges to be imposed—direct costs and overheads.

The cost of new terminal equipment to be sold should be accounted for separately from equipment to be installed. When the terminal equipment market is deregulated, these costs will be captured in a separate account, along with appropriate minor

materials and overheads and expensed as sold. The cost for in-stock and in-place equipment will be based on past historical average costs. These average costs should include appropriate minor materials and supply expense.

Repair costs, whether in a regulated or deregulated environment, include fully loaded labor costs (actual payroll taxes, pensions, supervision, vehicle, general and administrative expense and return) and material costs. If a regulated company uses and employee in this area, he would be billed out at a rate based on the fully loaded labor and material costs. The employee's time (fully loaded) would be charged to the appropriate expense account on a below-the-line basis.

6. Whether these operations will be conducted under tariff.

As noted above, Continental supports the deregulation of the terminal equipment and subscriber premise installation market since they are subject to competition from non-regulated entities. In order for telephone companies to be viable participants in the competitive marketplace, they cannot be constrained by tariffs. All operations in the terminal equipment and inside wiring markets must be conducted in a free, unrestricted manner so that company management can readily respond to changing consumer needs and market conditions. This also means that the telephone company must be relieved of any tariff obligations as a supplier of last resort for terminal equipment, inside wiring and repair of the same.

7. Whether operating or non-operating accounting treatment of gains and losses on the transactions is appropriate.

As indicated above, all transactions except sales of in-place and in-stock terminal equipment should be accounted for as non-operating gains and losses if these areas are deregulated.

Question 9. (Notice, ¶ 59) The Commission notes that several differences exist between Part 31 as written and as proposed to be revised, and generally accepted accounting principles. The Commission solicits comments on these differences as an item of inquiry. Two of the more significant items concern accounting for investments in affiliated companies (cost basis versus equity basis of investment) and accounting for financing type leases (expensing versus capitalization of lease costs).

Comment. Continental strongly urges that any revision of the USOA be consistent with generally accepted accounting principles. The current proposal does not provide sufficient account descriptions to determine if this objective is met.

The three significant areas where the existing USOA does not fully reflect generally accepted accounting principles are as follows:

1. Full interperiod tax allocation (including the debt component of capitalized "interest during construction") pursuant to APB Opinion No. 11.
2. The equity method of accounting pursuant to APB Opinion No. 18.
3. Accounting for "capital" leases pursuant to FASB Statement No. 13.

Although Continental believes that ratemaking based on the current recovery of costs, or deferred by generally accepted accounting principles, is desirable, it recognizes that there will be situations where the cost recognition allowed by regulatory commissions for ratemaking purposes will not be consistent with generally accepted accounting principles. In such instances, Continental suggests that the Commission's rules permit accounting consistent with such ratemaking in the manner set forth in the Addendum to APB Opinion No. 2. Accounting by regulated industries is now the subject of an FASB project, and Continental suggests that the revised USOA allow for any modifications in regulated industry accounting that may be finally prescribed by the FASB.

Question 10. (Notice, ¶ 62) The Commission invites comments on the degree of accounting uniformity the FCC should require among companies that will be subject to the provisions of the revised USOA. Specifically:

Question (a). Should the Commission only exercise its authority to prescribe accounts for larger telephone companies such as Class A carriers?

Comment. Continental recommends that uniformity within the USOA should be required among all telephone companies reporting to either federal or state regulatory bodies. The only differences should be the amount of detail in the subaccounts and the extent of the financial and non-financial reporting to the respective regulatory bodies. The same primary accounts should be incorporated in the system design. This would facilitate changes in carrier reporting requirements by minimizing the basic accounting changes required to progress from one level of reporting to another. In principle, smaller carriers should keep their records at a more summarized level than the larger companies.

Question b. How should the Commission define "larger" carriers for this purpose, e.g., in terms of revenues or assets, and at what levels?

Comment. Continental recommends that revenues continue to define the classes of carriers for purposes of prescribing accounting and reporting requirements. Revenues are a valid yardstick since over an extended period of time the amount of

revenues will be proportional to the company's expenses and plant investment, and an indication of the ability of a company to comply with the various accounting and reporting requirements. The level of revenues for each class is discussed below.

Question c. Should the Commission's rules require the use of uniform data storage or retrieval mechanisms of any particular type of function (e.g., specific data processing techniques) absent a showing of undue burden to a particular carrier?

Comment. Continental firmly believes that data processing methods should not be prescribed by either federal or state regulatory authorities. Choice of methods and procedures used to record and process data must remain a prerogative of industry management. Uniform procedures cannot account for the wide variance in individual companies' capabilities and circumstances. Some smaller carriers do not even possess data processing capabilities.

Question d. Should the same level of detail in supplemental records or subaccounts be required of all reporting carriers?

Comment. The same level of detail should not be required of all carriers. As explained above, the required level of detail must vary according to company size.

Question 11. (Notice, ¶ 62) The Commission requests comments as to whether the new system of accounts should apply only to the carriers with over \$1,000,000 in operating revenues. Specifically:

Question a. What questions will the Commission be unable to answer if these accounts do not apply to all Class A carriers?

Question b. What changes for other Class A and B carriers are needed for compatibility with this system if it is adopted for the largest carriers, as proposed?

Comments. Continental believes that the FCC's proposed revenue level of \$1 million is far too low for proposed Class A Company accounting and reporting requirements. The cost of implementing and maintaining the sophisticated data processing hardware and software, inherent in the FCC's proposal, is a major factor in establishing Class A requirements. A company must justify this cost based on such considerations as its number of employees, customers served, volume of construction activity, service order activity, type of areas served (urban versus rural), voucher activity and a host of other transaction volumes. A company with annual revenues of \$1 million simply does not have the volumes to justify such complex data processing requirements. (See p. 19 above, f.n.)

Based on Continental's experience, it recommends that for accounting and reporting purposes, telephone companies be divided into four classes as follows:

Class A Companies—annual operating revenues exceeding \$100 million, excluding those non-Bell companies which only concur in the interstate tariffs of other carriers;

Class B Companies—annual operating revenues exceeding \$25 million but not more than \$100 million, including those companies with greater than \$100 million in revenues which do not fall under Class A;

Class C Companies—annual operating revenues exceeding \$5 million but not more than \$25 million;

Class D Companies—annual operating revenues not exceeding \$5 million.

Continental recommends the following differentials by class be incorporated into FCC's accounting and reporting requirements:

1. Class A companies will keep all USOA accounts prescribed by the Commission which are applicable to their affairs. Under Continental's proposal, the service allocation procedures would be fully applicable to these companies.

2. Class B companies will keep all the accounts of the USOA, which are applicable to their affairs, except that accounts for operating revenues and expenses may be kept in a summarized manner. Allocations of plant investment, revenues and expenses to service will be performed under service allocation procedures.

3. Class C and Class D companies will be subject to less detailed accounting and service allocation procedures as appropriate by size and capability. Class C requirements should allow optional utilization of mechanized data processing equipment. Class D accounts and procedures should be capable of being efficiently maintained on a manual basis.

Senator SCHMITT. That would be helpful to us. Mr. Carr, did you have a comment on this?

Mr. CARR. One comment made there was that if you formed subsidiaries and each had to raise capital, it would increase costs to the ratepayers. But if the subsidiaries were formed to engage in competitive businesses, they would not have ratepayers or regulated rates of return.

Mr. LA BLANC. They will have somebody. A ratepayer whether he is a ratepayer because he is regulated or because he is a customer.

Mr. CARR. It would be a customer. There is a significant distinction. The rate of return for ratepayers is based on a regulator's formula, but the price a customer pays to one of numerous competitors is determined by the free market.

Our revenues must cover our costs. The American monopoly telephone ratepayer pays a good part of Bell's basic research and development budget. These are not comparable situations by any means.

Senator SCHMITT. You are not suggesting that somebody won't have to pay Bell Lab's costs if it was required that it be a fully separate subsidiary, are you?

Mr. CARR. Obviously, there is no free lunch. You develop products with human and financial resources. Our concern is that the domestic monopoly services telephone ratepayer now subsidizes all research and development that goes on within Bell Labs in its current structure, and that subsidy is not wholly applied to the services for that ratepayer. It is also applied to the development of A.T. & T. products used in competitive business communications.

Now, if Western Electric is divested, it will have to acquire research and development people and funding the way any other organization, including the members of our association, do, and will have to pass these costs on to the extent you can in a competitive market.

It is a different situation entirely than enabling A.T. & T. to finance everything through basic service and allowing it to decide on how to allocate resources.

Senator SCHMITT. Do you think Bell Labs could survive as an entity or be as productive?

Mr. CARR. Maybe even more productive. An organization operating in response to a free competitive environment will be more productive in the long term than one that is financially supported by monopoly revenues.

Senator SCHMITT. Some of their pure research doesn't have a market until it is well down the road. How do you sell something like pure research?

Mr. CARR. It is done by universities throughout the country.

Senator SCHMITT. Only to the Government. Unfortunately, even foundations are not supporting pure research like they used to.

Mr. CARR. That is an issue that should be of overriding concern in this country. I think another issue is whether the chairman of the board of A.T. & T. ought to be allocating the total resources provided by a ratepaying public into programs chosen by A.T. & T. management, rather than by the public at large, or Congress, or whomever. That is the way it is now.

Senator SCHMITT. Mr. Beach, did you have a comment?

Mr. BEACH. I had something I would like to add to what Mr. La Blanc said a few minutes ago. It's this: Certainly included within category II will be carriers having basic transmission facilities. All of those companies won't be huge companies. Therefore, they might not have a sufficient critical mass to engage in these nontransmis-

sion activities. So a separate subsidiary would not necessarily be warranted.

But the Congress has taken that into account in giving discretion to the FCC, after hearings, to determine when in a given case it is appropriate for one of the smaller basic transmission companies to have a separate subsidiary.

So I think you have addressed a concern that it might not be appropriate in certain cases.

Senator SCHMITT. Should we build in the legislation a realization that scale is a factor in this.

Mr. BEACH. Yes. I don't know where to draw the line. That is a question of economics and judgment.

Senator SCHMITT. The bigger the organization, the more basic research presumably they can fund, and there is less need to have a specific justification for that research.

Presumably that basic research is the leading edge 10 or 20 years from now that becomes the digital light tube technology we are seeing coming about today.

Mr. CARR. All the basic research is pretty well spread out if you look at the record. Bell Labs invented the transistor, which was an extremely valuable contribution to our society. The application of that technology and of the basic research and development resulted in the technology of large scale integration. This was not funded by Bell Labs, but in fact, by a private sector, which does not have a ratepaying public to support it.

We are not talking about giving up a national resource that does all our basic research.

Senator SCHMITT. I agree except sometimes maybe we are drawing an unrealistic distinction between the person who pays for a product and the ratepayer who pays for a service. I think that started to come out in some of Mr. La Blanc's comments. It is a difficult distinction to derive, particularly when you talk about divestiture. You remove something from the rate base and put it in the price base, and perhaps with increased competition those prices will drop faster than the rate would have dropped if we left it the way it was.

Mr. CARR. They don't drop. They go up.

Senator SCHMITT. There might be an argument with that, particularly if you relate it to the nature of the services provided as a function of time, along with the rate being paid as a function of time. That is a difficult comparison to make. But if you look at telephone rates today by themselves, and also in comparison with the quality and quantity of services being provided, maybe that statement wouldn't hold up.

Mr. LA BLANC. 1934, when the Communications Act was passed, it took better than 2 days take-home pay for the average worker to afford local residential phone service. It's 1½ hours take-home pay today. The only other example that flashes to mind offhand is the cost of a transcontinental phone call then as against now, or a study we did at Salomon Bros. a few years ago on what sectors of the economy were inflationary and which were not, and the one that came out being the least inflationary was communications.

So communications rates have gone down and/or, in an inflationary period they haven't gone up as fast as the CPI. I will have to

admit that a \$300 hand-held calculator 9 years ago that you can buy from these guys with the cardboard boxes on the streets in New York for a buck or two, that's quite a price reduction that has been affected by semiconductor technology. I admire it greatly.

It's on top of the dead bodies of an awful lot of semiconductor firms who went out of business making chips when they couldn't afford to.

Mr. CARR. In a free market.

Mr. LA BLANC. I am a free market man. I am with you.

I think you make a big mistake when you say rates don't go down. I don't think you are following the facts.

Mr. CARR. We should make a distinction between rates that increase and decrease in response to inflation or changes in the Consumer Price Index and those that change in an absolute sense.

While it is true that the average worker has to work less hours today because rates have lagged the Consumer Price Index, there is no comparison between what has happened to regulated rates for communications services and what has happened to prices for other high technology products and services.

For the latter, there has been an absolute decline. There has been an absolute decline in the number of participants in those industries. Successful participants remain and prosper and contribute to the public good. The others are plain gone. We agree on that point. I was troubled to hear the chairman of GTE this morning complain about the fact he wanted to acquire Telenet, which loses somewhere between \$5 million and \$10 million a year, and when the FCC applied restrictions, including cross-subsidization restrictions, he said he didn't think he would be able to make that acquisition.

I have to draw the logical conclusion that in order for Telenet to stop losing money, which they were doing in a free market, GTE was planning to subsidize it.

If the Commission wanted to prevent that cross-subsidizing, which we would think it should, Telenet will simply have to survive on its own.

Senator SCHMITT. Would you care to comment on this?

Mr. GARNETT. I would make a comment with respect to the requirement for separate subsidiaries. In my judgment it is possible to establish systems that will permit under surveillance the regulatory commissions and the companies themselves, to assure there is no cross-subsidization.

Senator SCHMITT. Mr. Inglis, do you have any comment?

Mr. INGLIS. Having spent most of my career in a competitive business, I must say I am bothered by the implicit assumptions being made by members of the telephone industry here, that the cost of providing services is an invariant number not susceptible to reduction by greater efficiency and so on.

Having been in a competitive environment, I know that at times when you just can't see any possible way to get your cost down enough to make a dollar selling at competitive rates, somehow or other you do find a way to do it. It's a tremendous spur to the efficiency which I don't think can be achieved in a regulated monopoly no matter how well managed it may be.

I think in the telephone company we have spur management, no question about it, but given competition, I am sure they would find ways to operate——

Senator SCHMITT. We are already seeing that under some of the court decisions. There is a tendency when you have a regulated monopoly, which has a public interest component to take that rate base as a given and expand services within it given a relatively constant cost.

How much more can you add? When you visit Long Lines and places like that compared to what it was 10 years ago or 20 years ago or 1934, you see such a fantastic increase in the ability to make a call and insure that the call gets through, the quality of the voice, and all the other services that may be provided through the same system.

When you look into the future you see so much more that can be done within the same rate base that it makes it difficult to compare.

I agree with everything that everybody said on this issue.

That is a nice position to be in for a politician. But I also think that legislatively we have to learn to outline a bit. You weren't here yesterday but if we are to do the three major things that everybody agrees need to be done, and have to be done by legislation, then we will have to try to figure out how to draw those lines and decide what to deregulate and what not to deregulate and when to force divestiture if necessary, and what not to and so forth.

The courts and the FCC are acting without congressional guidance. I don't think anybody wants that to continue.

The technology has outstripped the law and to a great degree, the ability of the courts and FCC to rule with respect to that technology. There are other considerations.

So we will have to do something. Your testimony is very valuable in helping us figure that out.

I would have one more question—about the separation and settlements procedure, Mr. La Blanc. You indicated that the access charge is compatible with the present procedures and and that the contribution can be phased out, I think you said, in 10 years.

Mr. LA BLANC. We used the same example that was set in the legislation. It said we wanted to phase out this contribution. We were using this as an example to say we had a system that worked and you could do it without going out and establishing a new fund or anything else and just do the same thing.

You may not want to do it in a lot of rural areas because if the true entity is to have parity in the rural areas, they may need a contribution for a longer or other period of time.

There is a way of doing it using the existing—that was the purpose of the example.

Senator SCHMITT. Our intent is to try to implement that. If you have some better language, I hope it's in what you submitted or you will submit to us.

Mr. LA BLANC. All right, I will be happy to.

Senator SCHMITT. Did you comment on the question of surcharge? Should the proposed Xerox service and similar services be surcharged to add to the access charge or to the contribution?

Mr. LA BLANC. I guess I feel that that is basically an injustice when you ask someone to pay for something that they are not accessing or using.

I recognize the problem. The problem is how to provide communications in sparse areas if you don't have some kind of a surcharge.

Senator SCHMITT. I get the impression you think that should be handled through an access charge for the facilities that are being used.

Mr. LA BLANC. If RCA drops an Earth satellite in and are not making access to the network, I will be damned if I see the justice in why they should have to pay a surcharge.

Senator SCHMITT. Anybody else want to comment?

Mr. GARNETT. I would not strongly object to that as a principle. I think what we are all searching for is some way to go from where we are now to eliminating some of the contribution that is being made to support local service.

If it can be done in other ways other than putting a surcharge on one who does not connect to the network in any way, then I would support no surcharge for anyone who does not.

Senator SCHMITT. Mr. Garnett, you expressed some concern, over giving the FCC authority to allocate markets and inhibit the phone companies from being able to compete equally.

Do you think that we can have true competition in markets where the telephone companies clearly have a dominant position?

Mr. GARNETT. I think where the telephone companies' position is dominant at a point in time where there has not been competition previously, that they should be permitted to compete with new entrants.

I believe we have seen entrants come into certain markets where there has been dominance already and the competitors have been able to make substantial inroads into the previously dominant market.

The terminal equipment market is one example. MCI and Southern Pacific. Recently ITT with the Execunet service and Spring service and so on.

I would strongly urge the telephone industry not be put in a position where it can't compete on fair and full terms. Otherwise, I believe the objective of full competition and the benefits of competition would be lost.

Senator SCHMITT. Thank you.

Mr. Inglis, a final question. With respect to the classification of carriers and services, S. 622 concentrates on the classification of carriers rather than services and attempts to provide the FCC with the flexibility in classifying carriers with congressional guidance.

Would you care to comment on that?

Mr. INGLIS. I think our concern is that we are going to be dragged willy-nilly into being a class II carrier under circumstances that weren't contemplated in developing this distinction.

We see no reason why we should be a class II carrier, for example, because Globecom, another subsidiary of RCA, is international.

Then we have another situation where they may be small specialized markets where we have a dominant position—we have that situation today.

We have 100 percent of the cable television market because of the way in which this works, the cable system Earth stations only link one satellite at a time and we have traffic on our satellite.

So here we are doing business, \$15 million a year maybe, something like that, and nevertheless, in that lighted area it would make us the dominant carrier if one interpreted the rules that way.

Other companies are free to compete with us. We are only dominant because of the peculiar situation. I think that is our concern.

If we do choose to go into an area where we are truly dominant because we have some legal or other basis that makes us that way, we certainly would accept the regulation.

But we would not want to drag the rest of the company along with it in an area where we have to compete.

I think it's a question of how the bill is worded in terms of statutory language. I am not an expert on that, but I can only point out the problem.

Senator SCHMITT. Could you provide some suggestions through your general counsel on classification?

Mr. INGLIS. We will do that; yes.

[The following information was subsequently received for the record:]

RCA AMERICAN COMMUNICATIONS, INC.,
Piscataway, N.J., May 14, 1979.

HON. ERNEST F. HOLLINGS,
Russell Senate Office Building,
Washington, D.C.

DEAR SENATOR HOLLINGS: Andrew F. Inglis' testimony before your Subcommittee recommended that the classification of carriers section of S. 611 be revised to give the Federal Communications Commission authority to waive the full separation requirements between Category I and Category II carriers if it were determined that full separation would impose an unreasonable burden because of the size and nature of the carrier. It was noted that a similar provision is already contained in Section 205(d)(3) of the bill. He also testified that an otherwise Category I carrier should not be deemed a Category II carrier solely because of its affiliation with an international carrier.

During the panel discussion, Senator Harrison H. Schmitt requested that specific legislative language be submitted to correct the problems we saw. In response to that request, the attachment to this letter contains the provision we recommend. I have also suggested changes to the Public Resource Use Fees sections to clarify that the fees are intended to raise only enough funds to cover the cost of the FCC and the National Telecommunications and Information Agency.

If there are any questions concerning these suggested revisions, please contact me.

Very truly yours,

CARL J. CANGELOSI,
Vice President and
General Counsel.

Attachment.

(1) Change Section 204(b) to read: "Any carrier which provides only services which are each subject to effective competition and which is not affiliated with a Category II carrier, other than an international carrier, shall be designated and regulated as a Category I carrier."

(2) Add to Section 204(g)(7): "The Commission may permit any carrier which provides both Category I and Category II services to be regulated as a Category I carrier for its Category I services where the Commission has determined that provision of the Category I and Category II services by fully separated carriers would impose an unreasonable burden because of the size and nature of such carrier, and that such condition will serve the purposes and policies of this Act."

(3) Change Section 106(b)(1) to read, in part: "Such fees shall reasonably reflect the relative value of the license issued to such licensees. The total amount collected by means of the non-broadcast fees shall not exceed the total costs of the Commis-

sion and the National Telecommunications and Information Agency less the amount of the fees levied upon licensees engaged in commercial broadcasting."

(4) Delete from Section 106(b)(2): ", including sealed bidding and oral auctions."

Mr. LA BLANC. Can I make one qualification to your question, which was: Is it fair for a company that isn't making use of local exchange to have to put in some kind of support payment?

The only qualification I would make in my answer is that it's really not fair if you make the assumption that 5 to 10 years down the line everything is an indistinguishable bit stream and someone makes a call from one Earth station to another and gets dropped into a computer and comes back out and goes out on a local phone network as a local call, at what point is that call using the local network and getting value from it?

That is the question. Where the example used before was from the site to this site and that's all, certainly there should be no—one should expect any contribution to be made.

Senator SCHMITT. What about the example of the large antenna in space that suddenly provides a very cheap antenna on each rooftop in every area served by Continental Telephone.

Mr. LA BLANC. I am hopeful we will do it. I think that will be very helpful when we do.

One of the problems—I am having a study done now in Continental—is to look at the traffic density from some little town to another little town and say you could serve that yourself, if you wanted to, out of the pooling association we are involved in?

It turns out there are such small—the community of interest within an area is so high, the community of interest outside as such low-range density, it's very difficult for some time to come to envision being able to do this.

Senator SCHMITT. If you start to include a broad spectrum of broadband services then it starts to change the picture economically, does it not?

Mr. LA BLANC. That is why we are doing the study.

Senator SCHMITT. Public safety, hospital, medical services, educational services.

Mr. LA BLANC. Absolutely. The time is coming very rapidly when we will be able to see it.

As of today, we have to look at some of these smaller communities. It's difficult to see where they will be generating in that bit stream. The other countervailing force, of course, is our friends have been doing so well in the data processing and the electronic chip very large scale integration that as the price of computer power comes down so fast, an awful lot of what we do today may be able to be compressed dramatically.

I watched a demonstration of a 64,000-bit-per-second line being compressed with a computer on either end into a 2,400-bit-per-second line. Then you say, gee—

Senator SCHMITT. Where did you say you were from?

Mr. LA BLANC. You begin to see some emphasis.

Senator SCHMITT. The future certainly is competition. Looking at it from another subcommittee—Science, Technology and Space Subcommittee—we may actually be moving more rapidly with respect to what we can do here on the ground than we are with respect to reducing cost and increasing capability of our satellites.

Mr. LA BLANC. I believe that, too, when you look at what semi-conductors are doing, you may be able to—today if you required one 64 kila bit line to handle voice, and tomorrow you can handle 50 voices on that same line, then you say to yourself, the satellite up there handling 4,000 to 6,000 voice channels today may be able to handle 50 times that or 25 times that tomorrow—the ground is what is doing it, not the satellite.

It's very exciting.

Senator SCHMITT. The hearings will be recessed until May 9 at 10 a.m., when we will begin 3 days of hearings on the international communications provisions of S. 611 and S. 622.

The chairman, Senator Hollings, would also like to indicate we intend to be moving forward on this legislation. Hence, we will be closing the record on the domestic portion of the testimony by the end of May.

Supplemental comments should be submitted accordingly. Thank you, panel. It has been very interesting and we look forward to more contact with you.

The hearing is recessed.

[Whereupon, at 4:15 p.m., the hearing was adjourned, to be reconvened Wednesday, May 9, 1979, at 10 a.m.]

AMENDMENTS TO THE COMMUNICATIONS ACT OF 1934

WEDNESDAY, MAY 9, 1979

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, D.C.

The subcommittee met at 10:10 a.m., in room 235 of the Russell Senate Office Building, Hon. Ernest F. Hollings (chairman of the subcommittee) presiding.

Senator HOLLINGS. Good morning.

We begin 3 days of hearings on the international provisions of S. 611 and S. 622. As at prior hearings, each witness will have 10 minutes, and the panel will hear. We have the distinguished Chairman of the FCC, then we have Mrs. Ruth Phillips—will she come forward, please—from the State Department, and Commissioner Abbott Washburn, from the FCC.

STATEMENTS OF HON. CHARLES FERRIS, CHAIRMAN, FCC;
MRS. RUTH H. PHILLIPS, THE STATE DEPARTMENT; AND
ABBOTT WASHBURN, COMMISSIONER, FCC

Senator HOLLINGS. Please limit your opening statements to 10 minutes.

Mr. Ferris, do you want to start?

Mr. FERRIS. I will be glad to. I don't know if I can condense in 10 minutes something as complicated as this.

I am pleased, Mr. Chairman and members of the committee, to appear before this subcommittee to testify on the sections of S. 611 and S. 622 that address international communications matters.

Before turning to the provisions of those bills on the international area, Mr. Chairman, I want first to make clear my wholehearted endorsement of the policy thrusts contained in both S. 611 and S. 622 with respect to domestic telecommunications. Both bills, in my opinion, seek to encourage competition where feasible and to deregulate and thereby provide an adequate substitute for regulation. I strongly support the goals of both bills to provide more effective international facility planning and to increase competition in the provision of international telecommunications services.

The importance of international communications in the United States cannot be overstated. The terms and conditions imposed on the use of international telecommunications facilities abroad affect, for example, whether U.S. businesses will be able to increase their efficiency by transmitting information over international circuits free from unwarranted costs or constraints.

(1557)

U.S. international telecommunications services are presently provided by A.T. & T. and five principal international record carriers: ITT World Communications, Inc., RCA Global Communications, TRT Telecommunications Corp., Western Union International, Inc., and French Telecommunications Corp. These carriers provide voice, record, and data services between the United States and points all over the world. Services are provided over submarine cables in which the carriers hold ownership interests, indefeasible rights of use, and via satellite circuits leased from Comsat.

Comsat serves as the U.S. representative to Intelsat, a worldwide consortium responsible for the operation of an international satellite system. Comsat is primarily a carrier's carrier—that is, Comsat does not generally provide direct service to users. As a recent exception to this rule, the FCC has ordered Comsat to file an application, now pending before us, to provide international television transmission service directly to users.

In order to provide service, each current international service carrier obtains an operating agreement with the foreign entity on the other end of the circuit. New international carriers would also have to obtain operating agreements before they could provide services. Such agreements cover the facilities to be used, services to be provided, and financial arrangements.

In the facilities area, the U.S. carriers and their foreign correspondents jointly plan new facilities. Pursuant to the requirements of section 214 and title III, for radio, of the 1934 act, the FCC is charged with determining whether a proposed additional service, or the acquisition or construction of facilities, is in the public interest.

For the last several years, the FCC has been attempting to improve its part in this process. We have streamlined our processes through measures such as autogrant and blanket authorizations. Through new initiatives which I will discuss later, we have sought to improve the consultative process, which involves the European and Canadian carriers, as well as NTIA, the State Department, and the international service carriers. But these efforts, as well as the proposals contained in S. 611 and S. 622, must be measured against the goals of international telecommunications planning.

First, we should attempt to assure the development, in a timely fashion, of reliable and innovative communications services at the lowest possible cost. There is an important element of balancing here. Timeliness, reliability, and diversity in communications facilities can be increased. But such increases will result in additional costs that must ultimately be borne by domestic ratepayers or domestic taxpayers.

Facilities must be adequate in terms of quality of service and expected traffic volumes. But it is equally important that facilities not be overbuilt. Therefore, a mechanism to review private investment decisions must be retained to assure that domestic users pay the minimum necessary to avail themselves of the international services that they desire.

Second, we should strive to fulfill the substantial potential for competition in the provision of services, even though the potential for competition in the provision of facilities is limited.

Commission approval has already been given to several U.S. carriers to provide new services using international transmission facilities already in place. Our policies should continue to encourage new entrants and to stimulate competition in the service area.

Our third objective should be to provide for an integrated planning mechanism that embraces both cable and satellite technologies.

The integration of these technologies into a single master plan is complicated. Our task is made more difficult by our fragmented industry structure and by the different processes which now exist for the international planning of cable and satellite facilities.

Individual cable facilities are typically planned on a region by region or country by country basis. These bilateral plans are not always coordinated with each other. They are even more rarely linked to the satellite plans generated and implemented by Intel-sat.

Fourth, we should strive to insulate international telecommunications policy from short term political pressures. International communications policy should, however, take into account important foreign policy and national security considerations.

Finally, I believe that we should follow the basic principle enunciated in the domestic area by both S. 611 and S. 622: We should minimize the role of governmental intervention. Because of the unique structure of international telecommunications, all governmental responsibility cannot be abdicated. But any intervention can and should be carefully focused.

I would now like to turn my attention to the legislation now before you. I will address my remarks primarily to S. 611 because it would dramatically change the existing situation.

S. 611 focuses on two major issues relating to international facilities planning. It establishes a mechanism for integrating the domestic planning of international satellite and cable facilities. And it provides for a single entity to negotiate with foreign telecommunications entities in the facilities planning process.

In doing so, S. 611 would effect a major restructuring of our international carriers. In particular, it would radically alter Comsat's role in international communications.

Given the present state of technology and the present international institutional framework for facilities planning, the choice between cable and satellite facilities will not be made by marketplace forces. The choices will be made on the basis of sometimes conflicting business and Government analyses of needs and costs.

The threshold question raised by S. 611 is what should be the primary focus for domestic decisionmaking with respect to international facilities. Under the 1934 act, the process culminates at the FCC in rulemaking or adjudicatory proceedings.

By contrast, under S. 611, the primary responsibility would shift to a new private nonprofit entity, the International Facilities Management Corp., which would not own, but would plan, construct, manage, and operate the U.S. segment of all international transmission facilities. The new entity would provide facilities, not services.

Existing carriers, and any new carriers offering international service, would continue to enter into operating agreements with

foreign entities. These carriers would apparently participate in planning international facilities through a process that is not specified in detail in S. 611. This process, like other activities of the entity, would be under the general supervision of the entity's board, comprised of representatives of the carriers, users, and the general public.

The FCC's role with respect to international facilities planning would be minor. The FCC would be involved only if and when, after hearing, it determined the entity had exhibited a pattern of mismanagement and/or imprudent investment.

With its diverse constituent board and its direct operational responsibilities, the entity represents an imaginative attempt to place operational expertise and know-how within an institutional framework designed to promote the public interest. But is such an entity clearly more likely to make better choices among alternative plans than the FCC now can?

Before any new entity is designated as the key decisionmaker in the facilities planning process, we should be reasonably certain that it will have both adequate technical expertise and resources and an effective charter. We should also determine whether sufficient procedural safeguards exist to protect the vital interests of the public in obtaining innovative and reliable services at the lowest possible rates.

On the procedural side, S. 611 would reduce substantially the degree of public oversight of private entrepreneurial decisions. Key disputes are now resolved in open proceedings. Procedural safeguards exist to insure input from all interested parties. Review procedures are available to those who disagree with the outcome.

Under S. 611, differences will be resolved within the new entity's board room. As presently drafted, there do not appear to be clear review mechanisms. There is much to be said for making this decisionmaking process actually the public as opposed to internalizing it within an ostensibly public corporation.

Beyond these procedural questions, I think it is essential to focus on the extent to which the proposed alternative would provide real incentives for more rational international facilities planning.

The Commission has impressed on our overseas partners our belief in the need for better consultative relationships. All interested parties now understand the importance we attach to exchanges of information on planning methodologies and traffic forecasting. I believe that we would not have made such progress if the FCC lacked the authority to reject proposed facilities plans.

Without this authority, we would lack the leverage necessary to insist on a more rational planning process from the point of view of American consumers. While S. 611 does not go as far in this direction as other proposals presented to Congress, it does limit the FCC's role.

Under S. 611 the single entity might, of course, reject proposed facilities. The new entity might, however, place heavy emphasis on maintaining harmonious relationships with its overseas partners. Short term concerns for maintaining amicable relationships might overshadow long term economic or technical considerations.

S. 611 also attempts to provide for more effective representation of U.S. interests overseas in the planning and implementation of international services.

In this area, there are some obvious advantages to having a single entity. But the benefits may be limited.

A new single entity is unlikely to replace A.T. & T. in its present overseas role or to simplify substantially present correspondent relationships.

Under S. 611, the single entity is to advise and assist in "establishing and maintaining operating agreements or other relationships with foreign entities." This role may raise some difficult issues.

What if, for example, a new entrant wanted to establish correspondent relationships but established carriers opposed this? How would the conflict be resolved? Or what if one carrier was prepared to initiate a new data processing service with a new switching technology unavailable to other carriers? Could a single entity serve effectively as a disinterested representative for all the parties concerned?

I am not convinced that the boardroom of a public corporation is the most appropriate place for resolving such issues.

In many cases, the problems the entity would have to struggle with are regulatory or quasi-governmental. The broader public policy issues may be too complex to be effectively dealt with by the part-time public members of its board. Will the proposed single entity be able to develop an expert staff sufficiently independent of the carriers to bring an unbiased perspective to these complex matters?

To summarize, the single entity does attempt to deal with important and real problems. But I am not convinced that the likely benefits are substantial.

I see that the red light is on. I have about 5 more minutes, and I will stop if that is your wish, Mr. Chairman.

Senator HOLLINGS. The entire statement will be included in the record.

[The statement follows:]

STATEMENT OF CHARLES D. FERRIS, CHAIRMAN, FEDERAL COMMUNICATIONS
COMMISSION

Mr. Chairman and members of the subcommittee: I am pleased to come before the Subcommittee today to testify on those sections of S. 611 and S. 622 that address international telecommunications matters.

First, I want to express my appreciation to you, Mr. Chairman, and to Senator Goldwater for the thought and effort that has gone into these proposals to resolve some of the problems in the international arena. I have spent a considerable amount of my time as Chairman attempting to improve the international telecommunications planning process in the North Atlantic basin. And I have come to see the need for even greater efforts not only in the North Atlantic but in other parts of the world as well.

Before turning to the provisions of these bills dealing with international telecommunications, I want to make clear my wholehearted endorsement of the thrust of both S. 611 and S. 622 with respect to domestic telecommunications. These bills seek to encourage competition where feasible, and to deregulate where marketplace forces provide an adequate substitute for regulation. I also strongly support the goals of both bills to provide more effective international facility planning and to increase competition in the provision of international telecommunications services.

The time has come to update the provisions of the Communications Act of 1934. Both bills make significant contributions to the present policy debate.

The nations of the world have come to rely more and more on each other. Higher quality communications are both a cause and effect of this increasing interdependency. The importance of international communications to the U.S. is vastly understated by the mere cost of communications facilities. The terms and conditions imposed on the use of international telecommunications facilities abroad affect, for example, whether U.S. businesses will be able to increase their efficiency by transmitting information over international circuits free from unwarranted costs or constraints.

Before commenting specifically on S. 611 and S. 622, I would like to describe how international services are presently provided and regulated, and the goals that underlie the Commission's international telecommunications policies.

U.S. international telecommunications services are presently provided by AT&T and five principal international record carriers—ITT World Communications, Inc., RCA Global Communications, TRT Telecommunications Corporation, Western Union International, Inc., and French Telecommunications Corporation. These carriers provide voice, record, and data services between the United States and points all over the world. Services are provided over submarine cables in which the carriers hold ownership interests (indefeasible rights of use) and via satellite circuits leased from Comsat.

Comsat serves as the U.S. representative to Intelsat, a worldwide consortium responsible for the operation of an international satellite system. Comsat is primarily a carrier's carrier—that is, Comsat does not generally provide direct service to users. As a recent exception to this rule, the FCC has ordered Comsat to file an application, now pending before us, to provide international television transmission service directly to users.

In order to provide service, each current international service carrier obtains an operating agreement with the foreign entity on the other end of the circuit. New international carriers would also have to obtain operating agreements before they could provide services. Such agreements cover the facilities to be used, services to be provided, and financial arrangements.

In the facilities area, the U.S. carriers and their foreign correspondents jointly plan new facilities. Pursuant to the requirements of Section 214 and Title III (for radio) of the 1934 Act, the FCC is charged with determining whether proposed additional service, or the acquisition or construction of facilities is in the public interest.

For the last several years, the FCC has been attempting to improve its part in this process. We have streamlined our processes through measures such as auto-grants and blanket authorizations. Through new initiatives which I will discuss later, we have sought to improve the consultative process, which involves the European and Canadian carriers, as well as NTIA, the State Department, and the international service carriers. But these efforts, as well as the proposals contained in S. 611 and S. 622, must be measured against the goals of international telecommunications planning.

First, we should attempt to assure the development, in a timely fashion, of reliable and innovative communications services at the lowest possible cost. There is an important element of balancing here. Timeliness, reliability, and diversity in communications facilities can be increased. But such increases will result in additional costs that must ultimately be borne by domestic ratepayers or domestic taxpayers.

Facilities must be adequate in terms of quality of service and expected traffic volumes. But it is equally important that facilities not be overbuilt. Since marketplace competition does not now provide an adequate check on facilities construction, a mechanism to review private investment decisions must be retained to assure that domestic users pay the minimum necessary to avail themselves of the international services that they desire.

Secondly, we should strive to fulfill the substantial potential for competition in the provision of services, even though the potential for competition in the provision of facilities is limited.

Competition in the domestic field has resulted in new and specialized services. The need of U.S. customers for such services does not stop at the water's edge. Commission approval has already been given to several U.S. carriers to provide new services using international transmission facilities already in place. Our policies should continue to encourage new entrants and to stimulate competition in the service area.

Our third objective should be to provide for an integrated planning mechanism that embraces both cable and satellite technologies. Each technology has characteristics that suit particular communications requirements. Each will play a critical role in meeting our diverse communications needs.

The integration of these technologies into a single master plan is complicated. Our task is made more difficult by our fragmented industry structure and by the different processes which now exist for the international planning of cable and satellite facilities.

Individual cable facilities are typically planned on a region by region or country by country basis according to the cable's potential landing points. These bilateral plans are not always coordinated with each other. They are even more rarely linked to the satellite plans generated and implemented by Intelsat.

Fourth, we should strive to insulate international telecommunications policy from short-term political pressures. International communications policy should, however, take into account important foreign policy and national security considerations.

Finally, I believe that we should follow the basic principle enunciated in the domestic area by both S. 611 and S. 622: we should minimize the role of governmental intervention. Because of the unique structure of international telecommunications, all governmental responsibility cannot be abdicated. But any intervention can and should be carefully focused. To the extent that long-term facilities planning can reduce the likelihood that unnecessary facilities will be built, and to the extent that new service providers can enter the market, it may be possible to reduce the governmental presence significantly.

I would now like to turn my attention to the legislation now before you. I will address my remarks primarily to S. 611 because it would dramatically change the existing situation.

S. 611 focuses on two major issues relating to international facilities planning. It establishes a mechanism for integrating the domestic planning of international satellite and cable facilities. And it provides for a single entity to negotiate with foreign telecommunications entities in the facilities planning process.

In doing so, S. 611 would effect a major restructuring of our international carriers. In particular it would radically alter Comsat's role in international communications. The potential benefits should, therefore, be carefully weighed against the potential costs, including the impact of the industry restructuring. This proposal should also be balanced against the procedures available now or those that might result from more limited amendments to the 1934 Act.

The requirement for greater integration of cable and satellite planning is fundamental. Yet given the present state of technology and the present international institutional framework for facilities planning, the choice between cable and satellite facilities will not be made by marketplace forces. The choices will be made on the basis of sometimes conflicting business and government analyses of needs and costs.

The threshold question raised by S. 611 is what should be the primary "focus" for domestic decisionmaking with respect to international facilities. Under the 1934 Act, the process culminates at the FCC in rulemaking or adjudicatory proceedings based upon input from U.S. operating entities and, indirectly, their foreign partners.

By contrast, under S. 611, the primary responsibility would shift to a new private nonprofit entity, the International Facilities Management Corporation, which would not own, but would "plan, construct, manage, and operate the United States segment of all international transmission facilities." The new entity would provide facilities, not services.

Existing carriers, and any new carriers offering international service, would continue to enter into operating agreements with foreign entities. These carriers would apparently participate in planning international facilities through a process that is not specified in detail in S. 611. This process, like other activities of the entity, would be under the general supervision of the entity's board. This board would be comprised of representatives of the carriers, users, and the general public.

The FCC's role with respect to international facilities planning would be minor. The FCC would be involved only if and when "after hearing" it determined the entity had exhibited "a pattern of mismanagement and/or imprudent investment."

With its diverse constituent board and its direct operational responsibilities, the entity represents an imaginative attempt to place operational expertise and know-how within an institutional framework designed to promote the public interest. But is such an entity clearly more likely to make "better" choices among alternative plans than the FCC now can? Before any new entity is designated as the key decisionmaker in the facilities planning process, we should be reasonably certain that it will have both adequate technical expertise and resources and an effective charter. We should also determine whether sufficient procedural safeguards exist to protect the vital interests of the public in obtaining innovative and reliable services at the lowest possible rates.

On the procedural side S. 611 would reduce substantially the degree of "public oversight" of private entrepreneurial decisions. Key disputes are now resolved in

open proceedings. Procedural safeguards exist to assure input from all interested parties. Review procedures are available to those who disagree with the outcome.

Under S. 611, differences will be resolved within the new entity's board room. As presently drafted there do not appear to be clear review mechanisms to determine if the interests of one carrier, one class of carrier, or one class of user were unfairly weighed against the interests of others. Given the importance of these choices, there is much to be as if for making this decisionmaking process actually "public" as opposed to internalizing it within an ostensibly "public" corporation.

Beyond these procedural questions, I think it is essential to focus on the extent to which the proposed alternative would provide real incentives for more rational international facilities planning. I am not certain that the single entity would actually represent an improvement over existing procedures in this respect.

As a part of Docket 18875, the FCC proceeding involving planning for North Atlantic telecommunications services, the Commission has impressed on our overseas partners our belief in the need for better consultative relationships. All interested parties now understand the importance we attach to exchanges of information on planning methodologies and traffic forecasting. I believe that we would not have made such progress if the FCC lacked the authority to reject proposed facilities plans on the basis of inadequate economic and technical justification.

Based on this experience I am against any proposal that would eliminate the Commission's authority to review and reject facilities plans. Without this authority we would lack the leverage necessary to insist on a more rational planning process from the point of view of American consumers. While S. 611 does not go as far in this direction as other proposals, it does limit the FCC's role in the facilities review and planning process.

Under S. 611 the single entity might, of course, "reject" proposed facilities. The new entity might, however, place heavy emphasis on maintaining harmonious relationships with its overseas partners. Short term concerns for maintaining such amicable relationships might overshadow long term economic or technical considerations. Placing the burden of insisting on improved planning on an independent entity like the FCC—which has no ongoing operating or financial relationships to disrupt—has some obvious advantages.

If the Congress does decide to adopt the single entity concept, however, I strongly believe that the Commission should participate more fully in the facility planning process than is provided for now in Section 248. The Commission should have some "presence" in the planning process itself and all facilities plans should be submitted for FCC review.

S. 611 also attempts to provide for more effective representation of U.S. interests overseas in the planning and implementation of international services.

In this area there are some obvious advantages to having a single entity. But the benefits may be limited.

A new single entity is unlikely to replace AT&T in its present overseas role or to simplify substantially present correspondent relationships. AT&T would continue to have responsibility for overseas telephone services which represent over 85% of overseas traffic. It would be the entity most likely to have the information and expertise necessary to plan for such services. The other service carriers would continue to have operational relationships with foreign correspondents. The need for multiple service arrangements would, therefore, not be lessened.

Under S. 611, the single entity is to advise and assist in "establishing and maintaining operations agreements or other relationships with foreign entities." This role may raise some difficult issues.

What if, for example, a new entrant wanted to establish correspondent relationships but established carriers opposed this? How would the conflict be resolved within the new entity? Or what if one carrier was prepared to initiate a new data processing service with a new switching technology unavailable to other carriers? Could a single entity effectively participate as a disinterested representative for all the parties concerned?

I am not convinced that the board room of a "public corporation" is the most appropriate place for resolving such issues.

In many cases the problems the entity would have to struggle with are "regulatory" or "quasi governmental." The broader public policy issues may be too complex to be effectively dealt with by the part-time public members of its board. Will the proposed single entity be able to develop an expert staff sufficiently independent of the carriers to bring an unbiased perspective to these complex matters?

To summarize, the single entity does attempt to deal with important and real problems—integrating cable and satellite planning and increasing the effectiveness of overseas representation of U.S. carriers. But I am not convinced that the likely benefits are substantial.

If the benefits are uncertain, the many practical problems in implementing the single entity concept are striking. A major industry reorganization must be carried out. Existing carriers' ownership interests must be identified and valued. Disputes over valuation must be resolved. New operational practices must be developed. A major restructuring of Comsat would be required which could have a significant impact on its financial status and its current operations.

If the benefits of a single entity were clear—or were to become more evident in the future—I would not hesitate to recommend wrestling in detail with these serious practical problems.

I believe, however, that before we commit ourselves to the single entity concept with its attendant difficulties, we should ask ourselves whether our present procedures are preferable. They already have worked more effectively in the past year than ever before. They could, moreover, be improved by some specific limited amendments such as those proposed in S. 622.

As the Subcommittee is aware, the Commission has been engaged for the past several years in an effort to identify the least cost facilities plan for the North Atlantic region for the period 1980-1985 which is mutually acceptable to all parties concerned. There has been very significant progress to date on developing such a plan. But perhaps even more gratifying have been the efforts that have taken place among United States, European and Canadian interests to improve the facilities planning process for the 1985-1990 planning period and beyond.

In March of this year at a meeting on the North Atlantic consultative process, several steps were taken which should facilitate international planning. I am very hopeful that all U.S. entities—including Comsat—will cooperate fully in these processes.

I am encouraged by this progress in the facilities planning area. I believe we are well on our way toward solving the problems that marred earlier planning efforts. I am confident that we will be able to have similar successes as we extend our joint planning efforts to other regions of the world.

I am distressed, however, about the lack of progress in introducing new carriers and new services into the marketplace. For example, in 1977 the Commission authorized two new international carriers. Yet European entities have been reluctant to establish correspondent relationships with either of them.

We recognize, of course, that the competitive orientation of U.S. telecommunications policy differs from that of our overseas partners. There is a need for a mutual understanding of our differing policies, just as there is a need for genuine reciprocity in international telecommunications policy.

International comity in telecommunications policy is a two-way street. We should accord the priorities of foreign entities the same due regard that our priorities are afforded in their forum. But we must also seek to attain real reciprocity in our overseas relationships—both in the planning process and in the implementation of new services.

We must have some effective mechanism to help us reach this goal. I believe this mechanism should be some form of facilities review procedure.

A specific legislative imprimatur to this process such as provided by Section 226 of S. 622 would be very constructive. It would emphasize to our overseas partners the importance we attach to international planning and to real equity in our telecommunications relationships. In addition, certain amendments to the 1934 Act might provide a clearer definition of the Commission's role and of the procedures that are to be followed.

I do not believe that the FCC should be responsible for negotiating for specific facilities or operating agreements. But the FCC should be able to discuss with foreign entities issues relating to the overall framework for international services such as guidelines for facilities plans or service agreements. In addition, our approval should still be required for specific plans.

I would welcome an amendment to the 1934 act which would make explicit the Commission's authority to consider not only the interest of foreign entities in a particular facilities plan, but to factor in as well the nature of the overall reciprocal dealings between the U.S. and foreign nations. We might also be directed to periodically review the activities of the international service carriers including their correspondent relationships. After such a review the Commission could determine whether changes would enhance the goals of improved facilities planning and increased competition.

Legislation might also charge us to reduce, to the extent practicable, our review of individual international facilities and services. A more general certification for overseas activities might be implemented. At the same time, the Commission could be given discretion to substitute broad oversight, where appropriate, for existing circuit by circuit and tariff by tariff review.

There are special procedural problems involved in international facilities planning. I would support appropriate amendments, such as those found in S. 622, which would provide additional flexibility to the Commission as to how we consider sensitive international issues.

I would also encourage amendments to spur competition in the provision of services. In particular, I strongly support the deletion of Section 222. The United States Court of Appeals for the Second Circuit has declared that it had "rarely seen opacity quite as dense" as Section 222. It urged Congress "to clear away the debris it created thirty-five years ago * * *"

I believe that it is time to act. In view of the Commission's commitment to competition in the domestic arena, I foresee no problem in erasing the confusing boundaries between domestic and international carriers. I do believe, however, that the Commission should have discretion to require, where necessary and appropriate, the separation of domestic and international carrier activities into different corporate entities.

Finally, I wish to reiterate the importance of insulating international telecommunications policy decisions from short term political concerns. Both S. 611 and S. 622 recognize this critical concern. S. 622 provides that the Commission can consult "with appropriate Executive Branch agencies to determine the foreign policy and national security implications" of proposed facilities plans. This provision, together with a directive to the Commission to consider international relations in its review procedure is a sounder approach than leaving the facilities review process under the direct supervision of the Executive Branch where it might be distorted by concerns with the day-to-day conduct of foreign policy.

Thus, Mr. Chairman, I would not favor the adoption of the approach outlined in S. 611 at this time. I am convinced we all share the same goals—those set out so well in S. 611 and S. 622. I believe, however, that these goals are more likely to be achieved through our present procedures, modified to some extent.

These procedures can work—and work better. All the major participants in the process seem to be committed to developing improved consultative relationships.

The next eighteen months are crucial for our efforts in the facilities planning arena. In this time period we shall discover whether the past insular planning patterns—especially for satellite services—can be integrated into a new facilities planning process.

Our processes would be aided by the amendments to the 1934 Act which I described above. But I am certainly prepared to revisit the proposal outlined in S. 611 if our best hopes for the planning process are not realized.

Thank you very much for the opportunity which you have given me to present my views to the Subcommittee. I am ready to be of any assistance possible in your efforts to improve our international telecommunications policymaking for the 1980's and 1990's.

Senator HOLLINGS. Mrs. Phillips?

Mrs. PHILLIPS. Thank you.

I am pleased to appear on behalf of the Department of State to testify on S. 611 and S. 622, designed to amend the Communications Act of 1934. My views are only those of the Department, not the administration.

S. 611 proposes some sweeping changes in the management and negotiation of international facilities, and my remarks will be primarily addressed to these changes and what my Department perceives to be their probable effect. Facilities planning and negotiating have been matters of widespread concern in recent years, and we welcome the time, effort, and attention that have gone into devising the approach outlined in this bill.

It is the considered opinion of my Department, however, that the arrangements provided by this bill will not succeed in reaching their stated purpose.

The bill would establish an International Facilities Management Corporation whose authority would include the planning, construction, management, and operation of the U.S. segment of all international transmission facilities and participation as the designated U.S. representative in all planning and negotiations with foreign

entities, except for Inmarsat, concerning construction, operation and use of facilities. These are attributes of national posts, telephone and telegraph ministry, PTT; and it appears to be the intention of the bill to create a U.S. counterpart to foreign administrations.

We are cognizant of the need to be able to negotiate effectively with foreign administrations, but we do not believe that the organization of foreign entities provides a suitable model for the U.S. telecommunications industry.

The establishment of a single entity would be a drastic step, involving rather complex legal issues, which would still leave a number of areas of uncertainty. In testimony before another committee of the Congress, the State Department has gone on record as favoring an executive branch/FCC/carrier task force to develop facilities plans in consultation with foreign governments. The Department continues to believe that such a task force represents a preferable mechanism for insuring that U.S. policies and concerns are given international consideration and that U.S. plans reflect consideration of the concerns of foreign correspondents.

We also believe that the Departments of State and Defense should enjoy full membership in the task force to provide foreign policy and national security perspectives to its proceedings.

I would like to turn to specific sections of the bill.

Section 102(a) expands the FCC's jurisdiction to include all commerce in telecommunications and electronics equipment and services, information software, and information services. Inasmuch as such equipment and services play a significant role in U.S. exports and, in most cases, are already subject to Federal laws, regulations and guidelines, we believe that consideration should be given to limiting this extension to domestic commerce, if any such jurisdiction is warranted.

Section 103(34) gives a definition of telecommunications which departs from that incorporated in the International Telecommunications Convention 1973, which says: "Any transmission, emission or reception of signs, writing, images and sounds or intelligence of any nature by wire, radio, optical or other electromagnetic systems."

The United States is a party to this Convention, along with 153 other governments, and we believe we should adhere to this definition. We are sympathetic to the Commission's desire to have this legislation address the many new issues and concerns appearing under the rubric of information. We believe that, perhaps, a separate definition of information would meet this desire, and we would be pleased to assist the committee in developing one.

Section 242 establishes the corporation which would manage, but not own, all U.S. international facilities. The divorce of ownership and management is not necessarily an inherent impediment to effective operation. The very diversity of interests, however, which must be reconciled within the corporation, including the business judgments of the management which, on occasion, would inevitably conflict with the interests of end-users, leads us to question the corporation's ability to arrive at effective negotiating positions, other than at the lowest common denominator. When it is recalled that one of the principal motives for establishing the corporation is

to provide the United States with more negotiating clout, this question takes on more importance.

The merging of U.S. international facilities envisaged by the bill, which is supposed to permit the corporation to deal with foreign counterparts on a one-to-one basis, appears, on the contrary, to involve a new multiplicity of U.S. institutions: The executive branch, the FCC; the Corporation; the Consortium; and the carriers.

Since the carriers would continue to negotiate operating agreements, the corporation would negotiate facilities plans, and inter-governmental discussions would inevitably continue in one form or another, there would appear to be more, rather than fewer, risks of misunderstanding.

For both of these reasons we favor the task force which would establish overall plans within the carriers would be free to pursue their own aims, subject only to oversight confined to ratemaking considerations.

Section 243 prescribes the composition of the corporation's board of directors. It reflects a concern for balancing the interests of carriers, end-users, and the Government. It does not appear to us, however, to insure a suitable representation of the technology of satellite transmission. I will return to the matter of satellite policy when I discuss title VI. If such a corporation were to be established, we believe that at least one directorship should be reserved for the representation of satellite interests.

Section 247 provides generally for presidential supervision and instruction of the corporation in connection with its relationships and activities with foreign and international bodies. We support this concept as necessary to insure continuity of foreign policy.

We believe, however, that the specific coordinating role of the State Department should be made explicit. This seems especially desirable for us in that a specific role for NASA and an implied role for NTIA are outlined in this section.

Section 248 of the bill, while enjoining the FCC to give due regard to foreign relations considerations, would give the Commission substantial review authority over the actions of the corporation. This means that any negotiations between the corporation and one or more foreign administrations would necessarily assume a tentative character, potentially reviewable and reversible by the Commission.

As the findings in section 241 recognize, international telecommunications facilities and services represent joint undertakings. By their inherent nature, agreements establishing such facilities and services must reflect some accommodation by each of the parties. We would seek a valid negotiating process where the broad range of U.S. interests could be furthered. The authority of such a process would be enhanced by language clearly limiting the Commission's oversight to the ratemaking aspects of the U.S. share of international facilities and services.

Section 249 recognizes the foreign relations implications of telecommunications negotiations. We support this language and assure the committee that the Department would endeavor to play as helpful a role as possible, if the corporation were to be established.

Title V, establishing a national commission on spectrum management, appears to us to be primarily a domestic matter. We would, of course, monitor its activities to insure consistency with U.S. obligations to the International Telecommunication Union and other interested bodies, but we believe that the Commission and the National Telecommunications and Information Administration are in a better position than we to comment upon this proposal.

Section 603 would repeal titles I through IV of the Communications Satellite Act of 1962. The Department believes that the policies and mechanisms embodied in the Comsat Act have succeeded in fostering a global, efficient, and commercially sound telecommunications satellite system. To repeal title I without reaffirming our commitments to Intelsat would place this policy and U.S. commitment to it in doubt. It would also result in uncertainty with respect to the U.S. role in satellite organizations and our ongoing relations with them.

I would like to mention a matter not addressed by the bill. The Department favors amending the Communications Act to authorize foreign governments, under certain conditions, to operate base and mobile stations within 30 miles of their diplomatic missions in Washington. At issue is the granting of reciprocal privileges by some countries to permit similar operations by our embassies to effect better protection of the Ambassador and other U.S. Government personnel. We respectfully urge that the committee consider such an amendment.

Before turning to S. 622, I would like to comment on the bill's finding that there is fragmentation and duplication of U.S. representation in international telecommunications activities. Executive Order 12046, promulgated last year, is designed to ensure the coordinated development and execution of international telecommunications policy within the context of our overall foreign policy objectives. We worked closely with the White House staff and concerned Federal agencies in developing the Executive order, and we have continued to collaborate in achieving its aims.

I will submit the rest of my testimony for the record.

Senator HOLLINGS. Thank you.

[The statement follows:]

**STATEMENT OF RUTH H. PHILLIPS, DEPUTY ASSISTANT SECRETARY OF STATE FOR
COMMERCIAL AND TELECOMMUNICATIONS AFFAIRS**

Mr. Chairman, I am pleased to appear on behalf of the Department of State to testify on S. 611 and S. 622 designed to amend the Communications Act of 1934. My views are only those of the Department, not the Administration.

S. 611 proposes some sweeping changes in the management and negotiation of international facilities and my remarks will be primarily addressed to these changes and what my Department perceives to be their probable effect. Facilities planning and negotiating have been matters of widespread concern in recent years and we welcome the time, effort, and attention that have gone into devising the approach outlined in this bill. It is the considered opinion of my Department, however, that the arrangements provided by this bill will not succeed in reaching their stated purpose.

The bill would establish an International Facilities Management Corporation whose authority would include the planning, construction, management and operation of the United States segment of all international transmission facilities and participation as the designated United States representative in all planning and negotiations with foreign entities (save INMARSAT) concerning construction, operation and use of facilities. These are attributes of a national posts, telephone and telegraph ministry (PTT), and it appears to be the intention of the bill to create a

United States counterpart to foreign administrations. We are cognizant of the need to be able to negotiate effectively with foreign administrations, but we do not believe that the organization of foreign entities provides a suitable model for the United States telecommunications industry. The establishment of a single entity would be a drastic step, involving rather complex legal issues, which would still leave a number of areas of uncertainty. In testimony before another committee of the Congress, the Department has gone on record as favoring an Executive Branch/FCC/carrier Task Force to develop facilities plans in consultation with foreign governments. The Department continues to believe that such a Task Force represents a preferable mechanism for ensuring that United States policies and concerns are given international consideration and that U.S. plans reflect consideration of the concerns of foreign correspondents. We also believe that the Departments of State and Defense should enjoy full membership in the Task Force to provide foreign policy and national security perspectives to its proceedings.

If I may refer to specific sections of the bill:

Section 102(a) expands the Federal Communications Commission's jurisdiction to include all commerce in telecommunications and electronics equipment and services, information software, and information services. Inasmuch as such equipment and services play a significant role in U.S. exports and, in most cases, are already subject to federal laws, regulations and guidelines, we believe that consideration should be given to limiting this extension to domestic commerce, if any such jurisdiction is warranted.

Section 103(34) gives a definition of telecommunications which departs from that incorporated in the International Telecommunication Convention (Malaga-Torremolinos, 1973), viz: "Any transmission, emission or reception of signs, writing, images and sounds or intelligence of any nature by wire, radio, optical or other electromagnetic systems." The United States is a party to this Convention, along with 153 other governments, and we believe we should adhere to this definition. We are sympathetic to the Committee's desire to have this legislation address the many new issues and concerns appearing under the rubric of "information." We believe that, perhaps, a separate definition of "information" would meet this desire and we would be pleased to assist the Committee in developing one.

Section 242 establishes the Corporation which would manage, but not own, all United States international facilities. The divorce of ownership and management is not necessarily an inherent impediment to effective operation. The very diversity of interests, however, which must be reconciled within the Corporation, including the business judgments of the management which, on occasion, would inevitably conflict with the interests of end-users, leads us to question the Corporation's ability to arrive at effective negotiating positions, other than at the lowest common denominator. When it is recalled that one of the principal motives for establishing the Corporation is to provide the U.S. with more negotiating clout, this question takes on more importance.

The merging of United States international facilities envisaged by the bill, ostensibly to permit the Corporation to deal with foreign counterparts on a one-to-one basis, appears, on the contrary, to involve a new multiplicity of U.S. institutions: the Executive Branch; the Federal Communications Commission; the Corporation; the Consortium; and the carriers. Since the carriers would continue to negotiate operating agreements, the Corporation would negotiate facilities plans, and intergovernmental discussions would inevitably continue in one form or another, there would appear to be more rather than fewer risks of misunderstanding. For both of these reasons we favor the Task Force which would establish overall plans within which the carriers would be free to pursue their own aims, subject only to oversight confined to ratemaking considerations.

Section 243 prescribes the composition of the Corporation's Board of Directors. It reflects a concern for balancing the interests of carriers, end-users and the Government. It does not appear to us, however, to ensure a suitable representation of the technology of satellite transmission. I will return to the matter of satellite policy when I discuss Title VI. If such a Corporation were to be established, we believe that at least one directorship should be reserved for the representation of satellite interests.

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substantial review authority over the actions of the Corporation. This means that any negotiations between the Corporation and one or more foreign administrations would necessarily assume a tentative character, potentially reviewable and reversible by the Commission. As the findings in Section 241 recognize, international telecommunications facilities and services represent joint undertakings. By their inherent nature, agreements establishing such facilities and services must reflect some accommodation by each of the parties. We would seek a valid negotiating process where the broad range of United States interests could be furthered. The authority of such a process would be enhanced by language clearly limiting the Commission's oversight to the ratemaking aspects of the U.S. share of international facilities and services.

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Section 603 would repeal Titles I through IV of the Communications Satellite Act of 1962. The Department believes that the policies and mechanisms embodied in the ComSat Act have succeeded in fostering a global, efficient, and commercially sound telecommunications satellite system. To repeal Title I without reaffirming our commitments to INTELSAT would place this policy and United States commitment to it in doubt. It would also result in uncertainty with respect to the United States role in satellite organizations and our ongoing relations with them.

I would like to mention a matter not addressed by the bill. The Department favors amending the Communications Act to authorize foreign governments, under certain conditions, to operate base and mobile stations within thirty miles of their diplomatic missions in Washington. At issue is the granting of reciprocal privileges by some countries to permit similar operations by our embassies to effect better protection of the Ambassador and other U.S. Government personnel. We respectfully urge that the Committee consider such an amendment.

Before turning to S. 622, I would like to comment on the bill's finding that there is "fragmentation and duplication of United States representation" in international telecommunications activities. Executive Order 12046, promulgated last year, is designed to ensure the coordinated development and execution of international telecommunications policy within the context of our overall foreign policy objectives. We worked closely with the White House staff and concerned federal agencies in developing the Executive Order and we have continued to collaborate in achieving its aims.

I would like to address two points in S. 622, which affect our foreign policy interests: the facilities planning mechanism and the selection of delegations to international meetings. The planning process foreseen by the bill is, in many ways, similar to the consultation and planning process evolving at present under existing legislation. While we have many reasons for optimism with respect to what is now evolving, we favor the Task Force approach as I explained earlier. The Task Force approach permits the Executive Branch to inject foreign policy and national security considerations into the process at an early date rather than waiting for the Commission to decide when an issue was sufficiently ripe to warrant consultation with the Executive Branch.

Before leaving the subject of facilities planning, I should like to mention Section 226(4)(f) which extends the oversight of the President to facilities planning. We appreciate the diversity of opinion which currently exists as to the extent to which State Department guidance to ComSat is binding and we appreciate the manner in which this language would ensure that national security and foreign policy considerations could be applied to all categories of international facilities. I should underscore, however, that its successful implementation will require a continuation of the spirit of cooperation and mutual respect which has characterized ComSat's relationship with the Government up to the present.

Section 226(4)(g) covers the selection of delegates to international telecommunications meetings. Sub-section (2) appears to impinge upon the discretion of the Secretary of State in accrediting delegations. The substitution of "may" for "shall" would recognize his authority. I would hasten to add that representatives of other interested agencies are frequently nominated to our delegations where their expertise is very useful.

Section 226(g)(3) is apparently directed at the recently-adopted Department Guidelines on Participation of Private Sector Representatives on U.S. Delegations. The Department's Guidelines do not prohibit the participation of private sector representatives on United States delegations to international telecommunications conferences. Indeed, they specifically recognize the important role of such representatives, and they permit such representatives to explain technical or factual points. The Guidelines do prohibit private sector representatives from negotiating for or speaking on behalf of the United States. In this respect, I note that a major purpose of the Guidelines was to ensure that private sector representatives would not be considered special government employees and thus subject to conflict of interest laws.

Section 226(g)(3) is apparently intended to allow private sector individuals to serve as special government employees, i.e., to negotiate for or represent the United States, without being subject to the federal conflict of interest laws. We think a blanket exception of this sort would convey an appearance of impropriety.

We believe that in most international telecommunications meetings the United States has an adequate number of highly qualified government employees to represent its interests; in these meetings, the proper role of private sector representatives is to provide the responsible U.S. Government officials with on-the-spot views and information based on their private perspectives.

We recognize, however, that in a very few cases—meetings of a highly technical nature such as the International Radio Consultative Committee (CCIR)—overall U.S. interests might better be served by allowing private sector experts to speak on behalf of the United States. We are thus prepared to support a limited statutory exception to the conflict of interest statutes in these cases, subject to a determination in each case that there is no significant real conflict of interest and that the national interest in the individuals' acting on behalf of the United States—deriving, for instance, from the lack of a government employee qualified to represent the U.S.—justifies the individuals' official participation notwithstanding his or her outside interests or affiliations. Under such a statute, we would expect to make public any exceptions made and, of course, any private sector individual would continue to be subject to the authority of the head of delegation and obliged to adhere to the official U.S. position.

We believe that the section as presently drafted presents serious problems. For example, as I mentioned earlier, it implies that private sector representatives are not now members of United States delegations, which is not the case. Also, while an exception is made with respect to Section 207 of the United States Code, other applicable sections of the conflict of interest statutes are not included. We and representatives of the Department of Justice would be happy to work with your Committee to achieve satisfactory resolution of these questions.

Sub-section (h) recognizes the vital importance of information and telecommunications services in the domestic and international economies and proposes a Presidential policy study. In the past two years, the Executive Branch has assigned a higher priority to these issues and had adopted new organizational approaches. These are reflected, for example, in the assignment of overall responsibility for the implementation of international communications policy to the Deputy Secretary of State, the establishment of the International Communication Agency, the establishment of the National Telecommunications and Information Administration, and the establishment of a National Security Council Working Group on International Communications Policy. These changes, together with a discussion of major communications issues facing the United States, are contained in a report submitted to the Congress earlier this year pursuant to Section 601 of Public Law 95-426. We are actively pursuing aspects of communications policy in a variety of forums, ranging from UNESCO through the International Telecommunication Union and the Organization for Economic Co-operation and Development, and would be pleased to discuss our activities with the Committee at its convenience.

[The following information was subsequently received for the record:]

DEPARTMENT OF STATE,
Washington, D.C., July 3, 1979.

Hon. BARRY GOLDWATER,
U.S. Senate,
Washington, D.C.

DEAR SENATOR GOLDWATER: This is in reponse to your letter of May 25 requesting an answer to the following question:

Would Section 226(g) of S. 622 allow ComSat to be a member of the United States delegation to the Assembly of Parties of Intelsat and permit those delegates to

speak at such meetings? If not, please provide alternative language which would allow ComSat to participate in such meetings.

Section 226(g) is not necessary to allow ComSat to be a member of United States delegations to the Assembly of Parties. ComSat has, in fact, been invited to participate and has served on United States delegations to the four Meetings of the Assembly of Parties held to date. Owing to ComSat's practical experience and expertise, we would anticipate inviting it to participate in future delegations.

The nature of such participation has been discussed with ComSat in recent months, owing to a review by the Departments of State and Justice of delegation selection and organization practices and the issuance of guidelines for the participation of individuals from the private sector in United States delegations to international conferences. Under these guidelines, advisers from private industry may speak to address or explain technical or factual points. They may not, however, speak on behalf of the United States or engage in intergovernmental negotiations. The legal rationale for these constraints is found in the conflict of interest statutes. (I would add that these constraints in no way impinge upon a private sector adviser's right to advise the head of delegation.)

In my May 9 testimony (excerpt enclosed), I pointed out that a blanket exception to the conflict of interest statutes posed a problem for my Department. We are prepared to support limited exceptions designed to meet particular problems, such as United States participation in the proceedings of the International Telecommunication Union's International Consultative Committees where issues of a highly technical nature are discussed. We do not believe the Assembly of Parties fits these circumstances.

In considering the above, it is well to take into account the differing natures of meetings of the Board of Governors of INTELSAT and of the Assembly of Parties. In the former, the United States is represented by ComSat as its designated entity; the Board considers technical, operational and financial issues arising out of the designated entity's obligations pursuant to the INTELSAT Operating Agreement. With respect to the latter, however, Article VII of the INTELSAT Intergovernmental Agreement specifies that the Assembly "... shall give consideration to those aspects of INTELSAT which are primarily of interest to the Parties as sovereign States." We believe that in these circumstances the United States should be represented by government officials rather than private citizens employed by a corporation operating for profit, notwithstanding the Congressional mandate given to ComSat in respect of INTELSAT. For this reason, we would be reluctant, even if authorized to do so, to name employees of ComSat to United States delegations to the Assembly of Parties in the capacities of Representative or alternate Representative. On the other hand, we are prepared to make every other reasonable effort to reflect the unique status of ComSat and the importance attached to that status by the United States Government.

I hope these considerations will lead you to agree with us that the current arrangements for ComSat's participation at the Assembly of Parties are appropriate. Nonetheless should you wish, representatives of the Department would be willing to meet with you to discuss further your concerns regarding the application of our guidelines to Assembly of Parties delegations.

Sincerely yours,

RUTH H. PHILLIPS.
 Deputy Assistant Secretary.

Enclosure: Excerpt from May 9 Testimony.

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Senator HOLLINGS. Now we will hear from Mr. Washburn.

Mr. WASHBURN. Thank you.

I am in agreement with the statements made by Chairman Ferris.

The purpose of sections 241 and 242 of S. 611, which establish an International Facilities Management Corporation, is to overcome "the difficulties with the present system of planning and management."¹ I wonder, though, whether these difficulties are all that great and whether radical surgery of the kind prescribed in this legislation is called for. As Chairman Ferris has said, the planning process is improving.

A master plan for facilities and their use in the 1979-85 period is now virtually complete. Substantial progress, also, has been made on a plan for the full decade 1985-95 with the European PTT's and Telelobe Canada.

As for the management process, it is hard to fault what has been accomplished under the present system:

Both technologies—submarine cables and satellites—have been utilized imaginatively and efficiently to improve the quality of service. This is reflected in the steady pattern of increasing customer acceptance. International service is the fastest growing sector of the Bell System, with compound growth rates of 25 percent a year since 1950. During each of the last 2 years the growth rate was 31 percent;

In the last 10 years overseas telephone rates have declined more than 50 percent on most major traffic streams;

Of how many other commodities in the marketplace today can such a trend be cited? I can think of none.

¹ Communications Act Amendments of 1979, Summary of Major Affected Areas, title II, pt. 2.

A 3-minute call New York to London once cost \$30. Today you can make the same call on nights and weekends for \$3.60, by International Direct Distance Dialing. Sixty-four countries can now be dialed direct.

All elements of the industry are financially healthy.

Yes, it's true that there was plenty of disagreement, robust debate, and give-and-take in the various meetings that led up to the TAT-7 decision. But was that all bad? Or was the public served by the process? In my view, the process insured that all relevant data, factors and options were given consideration and were debated, out-on-the table, publicly, that all the many players, governmental and private sector, had their say, and that the ultimate outcome was a good one for the consumer.

However noisy, the system worked. The question, then, is whether the proposals in S. 611 would be an improvement and, if so, whether the improvement would justify the drastic changes involved. It's difficult, of course, to foresee clearly just how the proposed structure—with its Facilities Management Corporation and the Consortium of owners—would work. But it seems to me to have a number of troublesome features.

Would it achieve, in the language of section 241(d), "full, fair, and effective competition among carriers"? Would it insure that "the benefits of such competition flow through primarily to consumers"? My guess is that it would not do so either, for a number of reasons.

First, the robust public debate now surrounding facilities choices would be muffled. Comsat's experience in providing satellite communications and as the U.S. representative to Intelsat would be virtually eliminated. Comsat currently has no operating agreements with foreign correspondents. Even if such agreements could be consummated, Comsat, in a very practical sense, would remain beholden to AT&T's traffic for any significant ownership in the consortium and resultant representation on the board of the corporation.

This would hardly be conducive to the open public debate over the two modes—cables and satellites—that has characterized U.S. facilities' decisionmaking. Instead of the healthy public illumination we have had of alternative investment decisions, these decisions would be internalized within the corporate board room of a single entity.

In addition, as Ruth Phillips has noted, the makeup of the board appears to be quite weighted in favor of cable, so that the intermodal debate in that private room would be unfairly balanced—and the decisions coming out would have less chance of being in the interest of the ratepayer. While it's true there would be four public members on the board, they would be part-time and presumably have no independent staffs. The issues they must deal with are extraordinarily complex.

The drive-shaft of vigorous intermodal debate before the FCC has produced much of the remarkable progress in this field. S. 611 would reduce the role of the FCC, as Chairman Ferris has stated, and it would stifle much of that debate.

Second, the nonprofit Facilities Management Corp. would enjoy most of the privileges and prerogatives of ownership, but it would

shoulder none of the obligations of ownership. Separating the "planning, management, and operational control" functions from ownership just does not rest on sound management principles.

It would diminish incentives toward the most efficient investments and operations. The corporation would simply pass all the costs along to the consortium—that is, the carriers—and, eventually, to the public. The only check, is that the Commission, after a hearing which determines that "the corporation has exhibited a pattern of mismanagement and/or imprudent investment," then the Commission may impose section 214 prior approval on construction and operation.² But it is unlikely that this ultimate check would ever be imposed, and then only after egregious abuses by the corporation.

Our present arrangements can be said, theoretically, to provide incentives to overinvest in facilities, but, Mr. Chairman, I fail to see advantages in this proposal which would make it preferable. Remedies of this kind, in extreme circumstances, are applied to sick industries—as, for example, in the case of Amtrak managing the railroads. But the international telecommunications industry is far from sick. In fact, it could be described as booming.

Lastly, the language of section 241(d) fosters competition, at least on the U.S. side. But section 251(c) states that "because of the limited number of carriers involved, it shall be presumed that no international carrier is subject to effective competition in the international transmission of telecommunications traffic. Every international carrier shall be designated as a Category II carrier * * *." The language also implies that effective competition cannot flourish under the proposed structure when the international carriers are directed to allocate traffic and revenues therefrom "among the domestic carriers in accordance with such formulae as the Commission may prescribe * * *."

In summary, I doubt that this untried arrangement, with serious built-in disadvantages, would be an improvement over our present known, workable, but admittedly not perfect, international structure. It would cause severe disruption to the industry and administer a blow to Comsat from which it could possibly not recover. It would amount to surgery which the patient doesn't need or want, and which the consulting physicians are not recommending.

Rather, I would prefer the approach taken by Senator Goldwater in S. 622. However, where he retains section 222 of the 1934 act, I believe that the distinction between domestic and international record traffic has been overtaken by events. As I testified last year before the House Communications Subcommittee, I would prefer simply to delete that section. This would also have the advantage of removing the statutory discrimination against Hawaii, Puerto Rico, and other U.S. territories.

Thank you, Mr. Chairman, for this opportunity to be heard on title II, part 2 of S. 611.

Senator HOLLINGS [presiding]. Thank you, Mr. Washburn.

Mrs. Phillips, did the Department of State submit legislation dealing with the foreign embassies that we had asked the Department of State to comment on?

We never did get that recommendation. Has that been sent up?

²S. 611, Section 248(b)(1).

Mrs. PHILLIPS. I think it has been sent up. We have spoken to this before.

Senator HOLLINGS. Mr. Ferris, on the consultative process, the legality of having you involved in that process, would you not be challenged as having made up your mind on a matter which was coming before you?

Mr. FERRIS. I don't believe so, Mr. Chairman. I think it depends, really, to a great extent on what the agenda would be for consultant meetings.

The efforts over the past year have focused on the so-called TAT-7 facility that was designed by the overseas entities and our U.S. carriers.

The information or methodology we exchanged, and the data we exchanged, was really part of an attempt to help the Europeans and the Canadians understand how we determined whether a facility was justified, and part of an effort on our part to find out how the 26 countries independently came to their position that a facility was needed.

I think the process that we went through was an open process. We not only invited, but we begged the other countries to come in and look at our methodology and the basis upon which we initially concluded that a new facility was not justified. We asked them to give us the benefit of their methodology and their analysis in the hope that we might be able to reach a common conclusion.

We were clearly not successful.

I think to some degree one can conclude that the FCC's process is far more advanced than the type of arrangement one can do in the boardroom of the PTT overseas. I think what consultative process is attempting to do is to reach a consensus amongst the United States and the foreign PTT's with respect to a common approach to the building blocks that undergird future decisions on expenditures of commonly used facilities.

It is this notion of the type of discipline we use, the methodologies that we rely upon, the building blocks of decisions that are the subjects of the consultative process. I don't think that this kind of generic discussion with respect to methodologies compels a particular decision or would lead to any form of disqualification from the standpoint of prejudice. The only form consists of statements by the Commission that we do as a Commission agree not to build facilities that are not needed and cannot be justified on the record. I don't believe this could disqualify us from making a judgment with respect to any plan that came before us.

I think that there is a distinction between the consultant process what looks at data and methodologies generally and the consideration of a particular application at least as I have seen it over the past 12 months.

Senator HOLLINGS. You say that competition should be encouraged in the provision of services, though competition in facilities is limited.

How can it be done?

Mr. FERRIS. In facilities?

Senator HOLLINGS. Yes.

Mr. FERRIS. I don't think that you will get competition in facilities building now because all of the carriers share commonly used facilities.

There is a joint facility planning. The process we have now looks at what the total traffic would be and makes judgments as to what facilities are needed. Where we hope to be able to see greater competition in future years is in the services that are offered by the various carriers and in the entry of new carriers.

The real innovation can be in services.

I think the linkage of the two processes is very, very important. I think the FCC does have the leverage under the present mechanism to be able to get attention from the overseas PTT's with respect to our particular concerns.

We are the only entity that has divided responsibilities for governance and a competitive environment. There are government-owned monopolies at the other ends of these lines.

The monopolies operate with much greater efficiency. They have much greater certainty with respect to their decisions, but to a great extent they don't tolerate competition and the pesty cargo that goes with competitors.

We have authorized new carriers to European countries but the European countries have been reluctant to enter into operating agreements with them.

We say, yes, you can offer this novel service internationally, but they have to go overseas and say to the foreign PTT we want to come in and have an operating agreement with you for this novel service. And the foreign PTT says, leave me alone. We have got enough traffic coming, and A.T. & T. can handle it, or the existing record carriers can handle it. Why do we have to deal with you? They may be treated in a cavalier way because the foreign PTT's like dealing with one person.

Our environment doesn't tolerate that, Mr. Chairman. I don't think you would want our environment to tolerate that.

I think the leverage that we presently have at the FCC lies in the authorization of facilities. We have these entities sitting around a common table and they want very much for the FCC to listen to them and to be sympathetic to their authorization requests.

I think it would be very, very germane in those meetings to put on the agenda the notion that we have some little entities that don't want facilities, but they want to offer services.

I think comity is a two-way street. We give to European entities in our forum the same consideration from the standpoint of our decisionmaking as they give to us.

And when we have authorized a carrier, we would expect them to be sympathetic to giving that carrier some sort of correspondent relationship.

I think the present situation, although it is not tidy and not crisp, does lead to a very thorough analysis of the criteria which should be used for international planning facilities. And it does look toward what the rate payer is going to pay.

I think it gives us leverage in international planning that could bring a greater sense of urgency to our correspondents overseas so that they will give due consideration to the competitive environment was have in the United States.

Senator HOLLINGS. How do we actually increase the effectiveness of our overseas representation; that is, of U.S. carriers?

You agree that the current situation does not provide an adequate representation of the U.S. interest in these international negotiations. Elaborate on that. How would you do that?

Mr. FERRIS. I think it does.

Senator HOLLINGS. You think it does? Do you think it does?

Mr. FERRIS. Yes. The system that we have goes back, to a great extent, to the nature of our government, the notion of a separation of powers, as opposed to the efficiency of a parliamentary system where you can make very swift decisions.

We have checks and balances built into all of our governmental decisions. And among the checks and balances that we have is that we have to have cost justifications.

The problem really arises because the authorization of a specific plan comes to us at the end of a long process. If the FCC got into the process early, it would remove a tremendous element of surprise to carriers who sit down and negotiate for, for example, 24 more cables across the Atlantic.

They all decide that such a proposal is justified. And at the end of that process, when everybody is agreed, they come to the FCC and the FCC surprises them by saying that the proposal is not justified.

What we hope that changes in our process will do is to get the FCC's premises, its priorities, its type of analysis as to whether an authorization should be granted, to be clearly understood so that there wouldn't be any surprises.

I think, to a great extent, even Ruth Phillips' notion that we should focus on the ratemaking would minimize that, I believe that what she recommends, would be of a tremendous disadvantage to carriers, because at the end of the process when everyone had come out very, very happy, we would say, no, you can't include these items in your rate base. Charge it off to your shareholders.

I think that would be a shock.

Senator HOLLINGS. Before I ask Mrs. Phillips to comment on that, I think since 1977, the FCC has authorized two additional carriers.

Mr. FERRIS. Yes.

Senator HOLLINGS. They haven't been able to get any operating agreements.

Mr. FERRIS. That's right.

Senator HOLLINGS. Therefore, they can't provide the service.

Why haven't they been able to get these agreements?

Mr. FERRIS. The overseas entities have been reluctant to enter into those agreements. We have authorized these entities but it takes two to tango. You have to be able to have your transmission get into that foreign country. You need authorization from that foreign country. And you have to work out what the financial arrangements will be.

Senator HOLLINGS. You said that you had leverage, and I wondered where it was.

Mr. FERRIS. It is coming in this consultative process. Now the foreign entities are putting new services on the agenda. We have had overtures to our common carrier bureau that show a new

sense of urgency about the carriers that we have authorized that don't have operating agreements.

I think the present process provides the leverage. I think it will yield benefits. I would hate at this time to abort that process before it has have a chance to yield some real benefit.

Senator HOLLINGS. Mrs. Phillips, do you want to comment further about the limitation of the FCC's role for ratemaking?

Mrs. PHILLIPS. Yes. I would like to stress that to a significant extent, our objectives have been met by the consultative process in the TAT-7 situation.

We think that the fact that the parties are talking to each other is a good thing. And I share Mr. Ferris' view that this is going quite well.

But while we are satisfied that some progress is being made, we recognize that this situation is an ad hoc process. It isn't one that could apply necessarily to any other situation.

We would be happier if we had a legislative mandate from the Congress that would confine the commission's role to ratemaking aspects.

We find that when we talk with the foreign governments, their frustration really comes from the fact that they have gone through a long process of negotiation with the private entities. And at the end of that process, they find that on one side, the whole process can be stopped. And for us, this is where the real crunch comes for our relationships with foreign entities.

We think the ratemaking process would protect the consumer.

The CHAIRMAN. Thank you, Mr. Chairman.

Mr. Ferris, I read your statement hurriedly, at least parts of it, and I was pleased to see that you agree that we should minimize the role of governmental intervention.

I would say that I think that is the basic thrust of both of these bills and also, of this committee in a number of its actions insofar as the number of the regulatory bodies are concerned.

You say that the integration of satellite cable technologies into a single facilities planning is essential. And I take it from what you have been saying here now, you would propose to achieve that through the consultative process.

Is that correct?

Mr. FERRIS. That is correct.

The CHAIRMAN. Can the FCC legally commit itself to accept plans that emerge through the process prior to a full hearing?

Mr. FERRIS. I don't want to be responding with metaphysics. But I think there is a distinction between the consultant process and the kind of informational base that underlie decisions and the approval of a particular facility.

The problems we have always had in analyzing the needs for new facilities in the North Atlantic, Senator Cannon, have been what are the traffic forecasts? What are the facilities that are needed?

As you know now, the instructions that are given to Intelsat are given, by the United States through Comsat by the State Department. There is NTIA, State Department, and FCC coordination of this but no one knows exactly how that would work if there were differing views.

The decisions that are made with respect to cable are made off to the side by the U.S. carriers dealing with their overseas entities.

But there has been no bridge at all between the building blocks, for those cable decisions and the building blocks for the Comsat decisions.

I think to a great extent what we have achieved in the consultative process and what was certainly evident in the commitment we had from all the U.S. carriers, including Comsat in Montreal was that we are going to get a common data base for the forecasts of all U.S. carriers including Comsat.

I think if you have a common data base, your chances of getting common decisions are going to be increased.

I think the process that we are moving toward is one that I think is going to provide the greatest likelihood of getting the same kind of decisions.

As you know, Senator Cannon, the Cept countries and the United States control a majority of Intelsat. So if together we come to a determination on what facility plans should be used for cables and satellites, we could control the Intelsat decision as to what satellite facilities would be utilized.

The CHAIRMAN. Have you given overseas carriers the impression that if they agree to a consultative planning process in which the FCC participates, that you would look favorably on plans which have altered this process?

Mr. FERRIS. No. What we have done in docket 18875 is very similar to what Senator Goldwater describes in his bill from the standpoint of acceptance of a plan.

We are looking at planning for the period 1980-85. And implicit in that, is the authorization of facilities to carry out that plan. One could say that the adoption of the plan carries with it the adoption of the authorization for the facilities. It would be inconsistent for us not to authorize a facility on grounds that we have gone over when we accept the plan.

The CHAIRMAN. It seems to me that if you get involved in a discussion with the methodology and forecasts, that you are really supporting the decisions that may take you into some legal problems later on.

I think Chairman Hollings raised that question as well.

Mr. FERRIS. Well, Senator, I don't believe so.

Because we have an open process, as we have, and because we invite comments on our methods of analysis, I don't think there is any form of prejudgment with respect to a particular facility.

I see no nexus at all between carrying on that type of open analysis and prejudgment. Every meeting that we have is open to analysis. We invite criticism of our methodology and our conclusions. We invite comment, we beg for it.

Since the process is conducted in the open, and since the consultative process recognizes that there may be differences in conclusions based upon the same building blocks, I don't see where there could be a disqualification.

The CHAIRMAN. Why do you believe that integration of cable and satellite technology to a single planning process is necessary?

Mr. FERRIS. I think what has happened historically has been independent entities making decisions with respect to facilities for satellite and cable.

And what you have is the potential for, and some people allege, the existence of, facilities that are not needed. There may be too much capacity authorized because you didn't have the entities making the decisions using the same assumptions for the traffic over the planning period.

And that does not benefit the ratepayer because the ratepayer ultimately pays for that excess capacity. And that, I believe, is what our charter is for under the act—to assure that the ratepayer is not abused by over-capitalization.

The CHAIRMAN. Mr. Washburn, you say that the only check on the gold-plating and overbuilding by the facilities management corporation is the FCC. Wouldn't you agree that the final users and the connecting carriers who have to pay the prices charged by the consortium have an interest in cheap and efficient facilities?

Mr. WASHBURN. Well, I would say that that is true. But they also have very distinct special interests of their own. And I think that the presence of the Commission there at the end of the line is important here and balance is needed for the public interest.

The CHAIRMAN. Most people have 40 percent of the seats on the board of directors. That is more than the carriers have.

Wouldn't you think that is a pretty good check?

Mr. WASHBURN. As I said, we all know how presidential appointees work. They are distinguished people, presidents of universities—I mean, corporate board members of this sort who are appointed by the President—would presumably not have staff; independent staff, anyway.

They are part time. They would come into this very complex set of issues and perhaps try to make decisions there when there are splits on the board. This muddies the process.

As Ruth Phillips said, the corporation is an additional layer here of players that are already complex enough.

The CHAIRMAN. These people represent the users. And I would think that the users generally have a basic interest in low prices.

Mr. WASHBURN. Again, I think this is perhaps a confusing thing to have the users in that—on that board. It is a very good thing in many ways because you do have the voice of the user there.

But supposing there is nothing in the bill that would prevent the Department of Defense from being on that board, and the other large users. Like General Motors and Citibank.

Now you inject entities of that sort on that corporate board with their particular interests. I have serious doubts as to whether or not it is going to be very useful, the end result.

The CHAIRMAN. I gather from what you said, I kind of got the indication that you thought Presidential appointees wouldn't be a right way to go.

You are not suggesting that the Presidential appointees system ought to be done away with, are you?

Mr. WASHBURN. No, of course not.

I don't think they could give the balance for the public interest on this particular corporation board.

The CHAIRMAN. You are a Presidential appointee. Wouldn't you expect that you would lend balance in a similar position?

Mr. WASHBURN. It is a part-time thing. I have been full time in Government for many years. But I read this bill to mean that you would have four distinguished people representing different elements of the public, perhaps a leading labor leader or some top person from business or a consumer group. But they would not be here working full time on these extraordinarily, complex things. And they might end up being the deciding vote in a donnybrook on that board. And they wouldn't be competent to deal with it.

The CHAIRMAN. You weren't suggesting that because there were only part-time people on the board, not full-time paid, that they wouldn't be able to represent the public, were you?

Mr. WASHBURN. I think they would do their level best to do that. But there are people here who are devoting their lives to studying this very complex business of international telecommunications, that those board members spending just a few days a year simply wouldn't have the expertise to do that and they wouldn't have the staff to make the valid decisions.

They would certainly try.

Senator GOLDWATER. I am enjoying your message. It is coming through rather clear.

Mr. Washburn, it appears from your comments, that there may be an error in S. 622. We intended to include Hawaii as a domestic point.

In reading S. 622, I can understand your interpretation. We will see that it is corrected.

I take it from listening to all of you that you prefer section 226 of S. 622.

I say that because, starting with Mrs. Phillips, on the first page, she said the bill would establish an international facilities management corporation, whose authority would include the planning, construction, management, and operation of all U.S. international transmission facilities, and participation of a designated U.S. representative in all planning and negotiations, et cetera, et cetera.

But then she goes on to find fault with that approach.

I am going to ask you to comment after I finish with Mr. Ferris. You say the international facilities management corporation would not own, but would plan, construct, manage, and operate the U.S. statement of all international transmission facilities.

Would any of you like to add anything to the criticism that you have either directly or indirectly levied at the other bill?

I will give you equal time. I think this is very important. A lot of people, particularly Members of the Congress, don't understand the very, very difficult problems of maintaining order, or even a place in international communications. They don't realize that since the writing of the old act back in 1934, when we had probably 30 countries to contend with, now we are talking about 150.

Would you like to elaborate on that?

Mr. FERRIS. Senator Goldwater, in my prepared remarks, I specifically said that I think that section 226 of your bill gives a very specific imprimatur on the consultative process which has evolved.

I think that specific endorsement of the process would be very, very constructive.

I hope that the remarks that I made today would back that up. I'm saying that I think the status quo should be given a chance to yield the benefits that I think are possible before we change.

I definitely would favor section 226 of your bill over the international features of Senator Hollings' bill. I hope sometime I will have the opportunity to testify on the domestic common carrier provisions of Senator Hollings' bill.

I know I will be extremely enthusiastic about the provisions.

Mrs. PHILLIPS. I would like to add that on section 226, we would very much prefer to see an approach which injects the foreign policy and the national security considerations into the process at a very early date, rather than to wait until the process has gone a long way down the pike and then, under certain dire circumstances, these considerations are then entered.

I address that point in my written statement.

Senator GOLDWATER. I don't see anything wrong with that. We would all operate better if we knew what our foreign policy was.

It would help. I have said that throughout my career as a Senator. When we talk about foreign policy, we talk about it generally without relating it to a particular part of the world.

Now let's see what we can accomplish by the proper use of the muscle in communications, if there is any.

I agree with you. And when my staff and the majority staff put this legislation together, that certainly should be made clear. It isn't necessarily part of every decision, because not every decision in this field is going to bear on foreign policy.

Mr. Washburn, would you care to comment?

Mr. WASHBURN. I would simply say that what is proposed in S. 611 seems to me is very drastic, strong medicine for an illness that isn't there. It certainly doesn't need this kind of radical surgery.

I prefer the approach in S. 622, which codifies the improvement that we have seen in the consultative process, and lets it go forward. And have that procedure work, rather than trying to substitute something as difficult as S. 611 proposes with the uncertainties of how it would work.

Senator GOLDWATER. Mrs. Phillips, there has been considerable discussion about Comsat's role in facilities planning through its participation in Intelsat. Will Comsat, acting as the United States designated entity, be subject to instructions from the Department of State? Sometimes there is confusion as to what the U.S. policy is on a particular issue, as there was last winter after enactment of the International Maritime Satellite Act. Although the Congress had designated Comsat to represent the United States in Inmarsat, interested nations of the world were awaiting the United States decision on whether we would use a European satellite, Intelsat, or make other arrangements, and Comsat, had no instructions on policy.

The question is: How can the United States do a more effective job of formulating United States international telecommunications policy and making these policies clear to Comsat or the designated entity?

Mrs. PHILLIPS. I have had a very active role, Senator, in the Inmarsat, Comsat instruction process. It is my impression that after very, very heated discussions between us, that we did come to

an agreement on policy on the very question you raised. We had a very difficult situation on the European side which we attempted to address by informal consultations before we got into a formal situation.

We went to several meetings in London to try to resolve some of these issues. I think we finally did arrive at an instruction which made it absolutely clear to the Inmarsat where we stood.

They are very satisfied with our policy. I see these people regularly at meetings. I don't think there is any confusion on this policy at this time.

I think it requires careful and very informed consultations. I think that we had a good relationship with Comsat. We worked very closely. There is mutual respect on both sides. We worked to improve this. This has been a very difficult negotiation.

After 4 years, we are bringing into effect with the very good working relations with the Congress, a very important organization.

Senator GOLDWATER. Thank you. I have a comment.

Every time we get people up here, Mr. Chairman, from the administration, they say they are not speaking for the administration.

I wonder if it would be possible to get somebody up here who could say that they are speaking for the administration.

Senator HOLLINGS. Well, if we were really doing that, we wouldn't have anybody here.

Isn't it true that the international record carriers, the IRC's, they tariff on a rate of return basis; is that right? When last was there a rate case?

Mr. FERRIS. Right. I think probably 1957, 1958.

Senator HOLLINGS. You haven't had one in 13 years?

Mr. FERRIS. Closer to 20, 22, I think.

Senator HOLLINGS. And what would you estimate the average rate of return is for international record carriers?

Mr. FERRIS. I don't know right offhand. I would estimate they are in excess of 15 percent. Some are 20 to 25 percent.

Senator HOLLINGS. Allegedly, when Xerox acquired Western Union International, it was about an 80 percent return.

Mr. FERRIS. I wouldn't contest that at all, Mr. Chairman. I think implicit in your question is something that I think—

Senator HOLLINGS. Is that competition?

Mr. FERRIS. No, it is apparent competition. I would be interested to see what the division of the market share has been historically, since 1967. I imagine that would vary significantly if there were genuine competition. I think some people question whether we should have rate base regulation if you have competition. I don't know why we are in the rate base regulation area when you have more than one competing carrier, if there is true competition. It seems to be an anomaly.

We have had an audit of IRC's. We have got a report submitted to us. We are going to have something before us in the fall. I think that the use of our resources elsewhere has prevented us from going into this area in great detail.

Senator HOLLINGS. Following through on Inmarsat, the consideration of Inmarsat legislation, we asked the FCC about the FCC rate

case, docket 1607. Without recapping—you can if you wish, but that case lasted 13 years, did it not?

Mr. FERRIS. I believe so.

Senator HOLLINGS. And Comsat's rates were reduced 50 percent?

Mr. FERRIS. That's correct.

Senator HOLLINGS. That was over Comsat's strong objections.

Mr. FERRIS. I don't think it was a consent agreement.

Senator HOLLINGS. And how much was refunded to the IRC's?

Mr. FERRIS. About \$192 million.

Senator HOLLINGS. Was that \$192 million used to reduce the IRC rates to the users?

Mr. FERRIS. There was a passthrough arrangement on most. I will submit it for the record, because I don't recall what the precise arrangements were. But I know there was an effort to pass through.

Mr. WASHBURN. That's correct.

Senator HOLLINGS. You can submit this information for the record.

When you talk about competition, the intermodal competition between satellites and cable. Does the FCC have a practice of assuring satellite use through proportional fill? Is that the policy of the FCC?

Mr. FERRIS. That is part of the process by which we forecast future use and the facilities that will be needed. We look at what is to be built and how it will be used. There are various methods of traffic distribution that use differing amounts of cable and satellite circuits. So that is part of the process we go through with respect to the justification for facilities, Mr. Chairman.

Senator HOLLINGS. With respect to the uses of facilities, is the proportional fill standard a competitive process?

Mr. FERRIS. I think in the facilities area one could say there is little potential for competition. I think the ratepayer is going to pay for excess facilities. So we must carefully compare the costs of facilities and differing mixes of cable and satellite.

I think the real competition should be in the provision of services, because all of these entities use both satellite and cable. So I think the focus should be on not having redundant facilities, we should closely examine the use of facilities and the justification for the capital expenditures for facilities.

Senator HOLLINGS. On the leverage of the FCC with these foreign entities, have you discussed this situation with any of the foreign entities?

Mr. FERRIS. It was raised in the Montreal meeting on the consultative process. The question of correspondent relations was actually discussed briefly at the meeting. And the very fact that it was raised, I think, makes the point very tellingly with respect to how the process works.

Senator HOLLINGS. Is there anything, Mr. Ferris, you would like to add in your limited time? Anything you wish to emphasize, Mrs. Phillips or Mr. Washburn?

Mr. FERRIS. Only one point. With respect to the reservations in my statement about your proposal in the international area, I think it is great to have that proposal ready to go if the consultant process doesn't work. I think the changes that your proposal would

make at this time are premature but it would be good to have it on standby in case the consultative process fails. I think the very fact it has been proposed by you is going to provide tremendous stimulus to make the consultative process work.

Rather than make the legislative change now, I think we can have the best of both worlds by using the consultative process and by having a proposal of such significance in the wings.

Senator HOLLINGS. Very good. We appreciate the appearance of each of you here this morning.

The record will remain open for that other information.

And we welcome the other panelists.

STATEMENTS OF HON. TANY S. HONG, STATE OF HAWAII; DR. JOSEPH V. CHARYK, COMMUNICATIONS SATELLITE CORP.; EUGENE F. MURPHY, RCA GLOBAL COMMUNICATIONS; AND RICHARD C. HOSTETLER, WESTERN UNION TELEGRAPH CO.

Mr. HOSTETLER. I am happy to present Western Union's views on the international aspects of the proposed bills. As we testified last week, our position generally is that we believe in more competition. I would state our position this way: We believe the national goal of universally available, reasonably priced and technologically efficient telecommunications service can be best achieved under competitive conditions, where decisions are made in the marketplace rather than by an administrative agency.

I would say that nowhere have the shortcomings of regulation been more manifest than in the international area under the present system. In my testimony last week, I spent a couple of minutes describing the services that Western Union provides, and I mentioned at that time that we do not presently provide international transmission services. We do pick up and deliver overseas traffic in the United States, but we turn that traffic over to the international carriers, and they control the price and the other terms of service to the user.

In effect, the three or four carriers who operate in that marketplace today have a monopoly. The situation which we have today stems from section 222 of the 1934 act, which was adopted in 1943. Prior to the enactment of section 222, Western Union did offer full international telegraph services between the United States and almost every major country.

However, section 222, which was enacted to authorize the merger of Western Union and the Postal Telegraph Company, in order to avoid the threatened insolvency of the domestic telegraph industry during wartime, required the merged carrier to divest itself of all international telegraph operations. This provision has recently been construed by the federal courts to mean that Western Union may not reenter the international communications market under the existing law, irrespective of what kind of service it might propose to provide.

Under section 222, the market for telecommunications services is fragmented between international and domestic services. International carriers may not, with certain exceptions, provide service directly to domestic users, except in five designated coastal gateway cities. And as I have said, domestic carriers like ourselves have not been able to provide international service to our custom-

ers except through interconnection arrangements with the international carriers, which we believe have no place in a competitive environment.

These arrangements add millions of dollars of unnecessary costs which have to be borne ultimately by the public. The artificial bifurcation of the marketplace is not required either by technology or economics or by any other condition. In our view, there is a single integrated market for all interexchange services, and all United States users in that marketplace should have the right to deal with the carrier of their choice for all of their telecommunication requirements.

The FCC has recognized the problems created by section 222 and Chairman Ferris has testified that he believes section 222 should be eliminated. And they have attempted in some piecemeal fashion to deal with the problems created by that provision to the limit of their statutory authority.

However, in our view, piecemeal Commission action in this area will not serve the public interest. For example, the FCC has indicated that it intends to take action very soon on pending applications of the international carriers, which would, in effect, eliminate the gateways concept and permit the international carriers to handle traffic directly in most major metropolitan areas.

If these applications were granted, the IRC's would be free to extend their operations to these centers without fear of competitive response from Western Union. They have estimated in their filing before the FCC that in the fourth year, they might capture as much as \$50 million of this business away from Western Union, which is equal to the net income of Western Union.

The effect of this, of course, would be to tighten the monopoly of the international carriers over the international business and make it less feasible for domestic carriers to provide effective competition if section 222 is repealed. They do not propose reduction of rates to the users, which should be one of the public interest tests. And thus the net effect of the expansion would be to enlarge the size and scope of the IRC's noncompetitive operations without any discernible public benefit.

We urge the Congress to take action to remove all of the barriers to competition posed by section 222. We hope this committee will endorse Chairman Ferris' earlier observation before the House subcommittee that any expansion of the international carriers' gateway authority prior to comprehensive legislative reform might properly be conditioned on the repeal of section 222.

I might say that in looking at the two bills, we believe that the outright repeal of section 222 which is proposed in S. 611 is preferable to the approach in S. 622, which would eliminate certain provisions of section 222 but not others. As I have noted, expansion of the IRC's domestic operating rights without provisions for a contemporaneous competitive spur to the IRC's would upset the balance sought to be created by section 222 and force Western Union and other domestic carriers to compete with one hand tied behind their backs.

If in fact the Commission does move to expand the gateways without waiting on Congress to act, then we would urge Congress

to move immediately to repeal section 222 without waiting for more comprehensive rewriting of the Communications Act.

Apart from the concern which we have with section 222 and its repeal, looking at the bills more philosophically, we prefer a more unstructured approach in the international market than S. 622 in particular contemplates. We don't think that the international market should be treated any differently from the domestic market. It should be regarded as part of a single market.

We see no need to treat the international carriers, either the existing carriers or any other carriers who enter that market, as category 2 carriers. We think regulation should be on the same basis as is contemplated under S. 611 in the domestic market.

The exception to that would be Comsat and A.T. & T., if the latter is permitted to provide competitive services, carriers that do own facilities and thus are in a position to dominate the marketplace through their control over the facilities; they probably should be required to operate through separate subsidiaries, as S. 611 does contemplate in the case of Comsat.

Similarly, we think both of these bills, particularly S. 611, call for greater Commission involvement in the facilities planning process than may be necessary. We are particularly concerned about the rather complex and institutionalized structure which S. 611 would create. My suspicion is that the rate of return regulation, if that were removed, as was suggested earlier this morning, that the concern over the ownership of facilities and the control of those facilities might well disappear.

In our case in particular, we certainly would have no interest in building facilities or in participating in the ownership of those facilities. It is important that the carriers that do own the facilities not be in a position to overcharge for them and that all carriers providing competitive services do have equal access, and S. 611 does provide for interconnection.

We believe Congress should make clear, in whatever legislation it enacts, that an expansion of competitive opportunity for U.S. carriers engaged in international telecommunication services, is at the heart of American policy.

Since it is just as essential for overseas users to communicate with the United States as it is for the U.S. users to communicate overseas, we see no reason why, in the long run, foreign administrations should be able or inclined to obstruct the realization of a clearly articulated congressional policy. If Congress makes its policy clear, we believe there will be little need for FCC involvement in the day to day implementation of that policy.

Thank you.

Senator HOLLINGS. Thank you very much.

Mr. Murphy?

Mr. MURPHY. I am president of RCA Global Communications, Inc. I am pleased to have this opportunity to appear before you to testify on S. 611 and S. 622 insofar as they would affect the international telecommunications industry.

RCA Globcom is a common carrier primarily engaged in furnishing record telecommunications services, including telex, telegrams, facsimile, data transmission and leased channels, between the United States and the rest of the world.

Contrary to some other comments here today, over the years, RCA Globcom pioneered many of the innovations that our industry offers today.

Again, with reference to other comments, I am not aware of any international record carrier earning anything near 80 percent on rate base. Regarding the recent Comsat rate reduction, I would like to assure you that RCA Globcom flowed through 100 percent of that rate reduction.

But, in addition, as a result of forces in the marketplace, RCA Globcom, which had obtained reductions from Comsat of approximately \$7.3 million, ended up by reducing its rates by \$2 million more than that, or approximately \$9.3 million.

In addition, this was not limited to RCA Globcom. Based on our understanding of the figures that were filed with the FCC, the industry, as a whole, flowed through 130 percent of the Comsat rate reduction, and that additional 30 percent was all attributable to the fact that individual carriers reduced rates to various parts of the world by differing amounts.

In order to meet those rates and stay competitive so we would not lose business, we at Globcom spent an additional \$2 million.

Certainly no false impression should be left on the record that there was any windfall to the carriers as a result of the Comsat rate reduction.

Quite the contrary—additional amounts, over the amount of the Comsat rate reductions—were flowed through to the public.

RCA Globcom was the first to introduce overseas leased channel service and telex service. Just a little over a year ago, we inaugurated Q-Fax service, the first commercial international digital facsimile service, which permits the high-speed transmission of documents overseas.

This existing communications service meets similar needs as the U.S. Postal Service's electronic mail proposal which is still in an experimental stage.

RCA Globcom has invested many millions of dollars in the latest technology to improve the speed, quality, and reliability of international communications services available to the public.

Yet, despite the universal impact of inflation, and greatly increased costs of labor and material, the rates charged today for the services we provide are in almost every case lower than they were 10 years ago.

S. 611 establishes as a primary objective that telecommunications should, to the maximum extent feasible, "be provided under conditions of full and fair competition." A similar goal is expressed in S. 622.

RCA Globcom is firmly committed to the principle of "full and fair" competition. While the domestic communications market was essentially noncompetitive until the early 1970's, RCA Globcom has faced vigorous competitive challenges throughout its 60-year history.

We believe that, over the years, we have amply demonstrated our ability to perform well in a genuinely competitive market.

RCA Globcom operates in the only sector of telecommunications—the furnishing of international nonvoice services—which is not dominated by a single entity providing monopoly services.

To assure full and fair competition, we therefore urge the Congress to maintain that environment and take care not to stifle, albeit unintentionally existing competitive forces.

In our industry, the maintenance and furthering of competition requires special treatment to prevent A.T. & T., Comsat, and Western Union from utilizing their historic monopoly advantages to the detriment of the present carriers as well as new entrants.

Industry structure: Before proceeding to specific analysis of the bills before this subcommittee, I should like to survey the international telecommunications environment, including the role Western Union might be expected to play. This survey will be useful in pointing out the substance of our concerns.

The U.S. international telecommunications industry consists of three major segments.

First, there is A.T. & T., which provides all international voice telephone services to and from the U.S. mainland as an extension of its domestic telephone service monopoly.

A.T. & T.'s annual revenues from international telephone service, excluding Canada and Mexico, are over \$800 million.

The second segment of the industry consists of carriers providing international record services, including RCA Globcom, ITT World Communications Inc., TRT Telecommunications Corp., Western Union International, Inc., FTC Communications, Inc., and also Hawaiian Telephone Co.

U.S.-Liberia Radio Corp., a subsidiary of the Firestone Tire & Rubber Co., also provides certain overseas record services.

These carriers provide services such as telegrams, telex, facsimile, data transmission, and leased—private line—channels for voice/data communications between the United States and overseas points. Annual revenues for this segment of the industry are approximately \$450 million.

The international record carriers at present only serve the public directly in five designated "gateway" cities in the continental United States. At these points, they solicit business directly and interconnect with domestic carriers, primarily Western Union, for the pickup and delivery of their traffic to U.S. points beyond the gateway cities—referred to in industry parlance as the hinterland.

To the extent additional competitors are allowed in, they will be seeking to serve basically this segment of the international communications market.

Comsat forms the third major segment of the U.S. industry. It has enjoyed a privileged position due to its quasi-governmental status.

Pursuant to the Communications Satellite Act of 1962, Comsat was created and given sole U.S. responsibility for participation in the ownership of the global communications satellite system contemplated by that act.

It is the only American communications entity presently entitled to deal directly with Intelsat and has recently been given a newly-expanded monopoly to Inmarsat. Comsat also is the sole provider of A.T. & T.'s Comstar domestic satellite system and is a partner in IBM's proposed domestic satellite venture.

A.T. & T. is the largest corporation in the world. It totally dominates the domestic and international voice market. If

A.T. & T. were allowed to provide international nonvoice communications service, it would, because of its inherent advantages, inevitably dominate the entire international telecommunications market.

There is no practical way to curb A.T. & T.'s monopoly advantages and therefore we agree with S. 611 that A.T. & T. should not be allowed to expand its monopoly into the international record market.

At present, A.T. & T.'s monopoly telephone service accounts for approximately two-thirds of the total international communications market of about \$1.2 billion annually.

The goal of full and fair competition cannot be achieved if A.T. & T. is allowed unfettered access to the remaining one-third of the market which now not only sustains all of the other existing carriers, but would presumably be expected to support new market entrants as well.

Since 1964, in recognition of its monopoly position, A.T. & T. has not been authorized to offer new nonvoice communications internationally. A.T. & T.'s ability to dominate the entire international telecommunications market, both voice and record, would be further enhanced by its domestic monopoly position.

For example, A.T. & T. could use the facilities of its domestic message telephone monopoly to exploit international dataphone service.

Due to this and the international record carriers' inability to obtain interconnection to these monopoly facilities on an equivalent basis along with A.T. & T. operating companies, A.T. & T.'s service would have an overwhelming and unfair competitive advantage.

We believe the prohibition against A.T. & T. entry into international non-voice telecommunications contained in S. 611, section 252(b), should be clarified to prevent the provision of such service by A.T. & T. through an affiliate or subsidiary.

The present language of S. 611, however, may go farther than is necessary to carry out its purpose of placing a check on A.T. & T.'s monopoly power in the international area.

Thus, the bill flatly prohibits any "international telecommunications carrier which provides international public message telephone service for which it is not subject to effective competition" from also providing "any other international telecommunications service."

Taken literally, the applicable language could apply to RCA Globcom because it provides telephone service between Guam and foreign points, which accounts for less than 1 percent of our operating revenues.

A minor amendment to S. 611 restricting the applicability of this provision to carriers which predominantly derive their overseas revenues from basic telephone service would deal with the specific problem of A.T. & T., while not placing an unintended hardship on smaller, nonmonopoly carriers.

Western Union: We have in the past supported proposals which recognized the competitive imbalance resulting from Western Union's monopoly posture in the hinterland markets by precluding Western Union from operating internationally for 5 years.

While Western Union has been permitted to exploit its domestic monopoly, and develop its markets virtually free of competition for 35 years, the international carriers have been confined to 5 U.S. cities.

Efforts to change this situation have been stalled at the FCC for over 7 years. At present, more than half of all international record traffic originates or terminates in the United States on Western Union facilities.

Immediate entry would provide Western Union with an opportunity—which it would have every reason to use—to take unfair advantage of its domestic monopoly position over telex and TWX services and divert the vast majority of international telex traffic to its own facilities.

Telex is the mainstay of the international record communications industry. Given Western Union's substantial and unearned headstart, as a practical matter, it will take considerably longer for the international carriers to establish themselves in the hinterland than it would take Western Union to make the requisite operating arrangements to enter the overseas market.

First, it will be necessary for the international carriers to build and develop appropriate nationwide domestic distribution systems. This task cannot be accomplished in a few months or even a few years.

On the other hand, we would anticipate that Western Union could, in a relatively short period of time, negotiate the necessary contracts and obtain the facilities to operate directly with the principal foreign administrations.

Second, it should be noted that Western Union presently has over 120,000 subscriber installations on its nationwide domestic telex and TWX networks compared to RCA Globcom's approximately 7,000 installations in only five cities.

Thus, Western Union's existing customer base is more than 17 times our size.

Immediate Western Union entry would imperil the large investment in facilities and plant made by the international carriers in reliance on present law.

Under the circumstances, in order to assure full and fair competition, we believe the international carriers must be afforded a reasonable opportunity to overcome Western Union's advantages which were not earned in the marketplace, but rather are an outgrowth of legal and regulatory conditions in existence for more than three decades.

We also do not believe that the public interest would be served by allowing noncarrier entities to interconnect their systems at the cable heads or Earth stations.

Only the largest users could take advantage of these arrangements, and the resulting divergence of revenue from the carriers would create additional pressure for rate increases to the smaller users who could least afford it.

We fail to understand the presumption in S. 611 that the international record carriers are noncompetitive.

Our industry derives no significant revenues from monopoly services, and not one carrier dominates any service in the market.

The important point, we believe, is that all nonmonopoly carriers should be treated the same; that is, either regulated or substantially deregulated.

Full and fair competition will not result where one group of competitive carriers, providing functionally equivalent service, is subject to more burdensome regulatory requirements than another.

RCA Globcom supports the provisions of S. 611 to limit A.T. & T. to basic telephone service in the international market but we have reservations about the requirement in section 252(a) that carriers must establish a fully separated entity for the provision of either their domestic or its international services.

RCA Globcom would interconnect on appropriate terms with domestic carriers, but it should also be able to continue to serve its customers directly, as well.

We believe this approach will substantially meet the objectives of S. 611 to encourage competition in domestic markets.

The allocation formula applied in section 251 does not recognize the practicalities of handling international telex and data traffic.

Like telephone calls, telex traffic from overseas is to a specific called party's number either on our own system or the system of a domestic carrier, which substantially limits or prevents such traffic from being allocated.

We therefore believe that the formula should be clarified, at the very least, to limit its effect to unrouted traffic only.

What is of overall concern to us here is the well-being of the international record carrier industry in an environment where others are free to manipulate statutorily granted advantages or to exploit monopoly status.

We believe it is in the public interest to foster an economically sound international record communications industry which has provided innovative, technologically advanced and cost-effective service.

We therefore urge that the proposed legislation be appropriately modified in accordance with the recommendations we have made and would be pleased to work with the subcommittee and the staff to this end.

Thank you.

[The statement follows:]

STATEMENT OF EUGENE F. MURPHY, PRESIDENT OF RCA GLOBAL COMMUNICATIONS

Chairman Hollings, Senator Goldwater and members of the Subcommittee, my name is Eugene F. Murphy. I am President of RCA Global Communications, Inc. (RCA Globcom). I am pleased to have this opportunity to appear before you to testify on S. 611 and S. 622 insofar as they would affect the international telecommunications industry.

RCA Globcom is a common carrier primarily engaged in furnishing record telecommunications services, including telex, telegrams, facsimile, data transmission and leased channels, between the United States and the rest of the world. Over the years, RCA Globcom pioneered many of the innovations that our industry offers today.

For example, we were the first to introduce overseas leased channel service and telex service. Just a little over a year ago, we inaugurated Q-Fax service, the first commercial international digital facsimile service, which permits the high-speed transmission of documents overseas. This existing communications service meets similar needs as the U.S. Postal Service's electronic mail proposal which is still in an experimental stage.

RCA Globcom has invested many millions of dollars in the latest technology to improve the speed, quality and reliability of international communications services.

available to the public. Yet, despite the universal impact of inflation, and greatly increased costs of labor and material, the rates charged today for the services we provide are in almost every case lower than they were ten years ago.

S. 611 establishes as a primary objective that telecommunications should, to the maximum extent feasible, "be provided under conditions of full and fair competition." A similar goal is expressed in S. 622. RCA Globcom is firmly committed to the principle of "full and fair" competition. While the domestic communications market was essentially non-competitive until the early 1970's, RCA Globcom has faced vigorous competitive challenges throughout its 60-year history. We believe that, over the years, we have amply demonstrated our ability to perform well in a genuinely competitive market.

RCA Globcom operates in the only sector of telecommunications—the furnishing of international non-voice services—which is not dominated by a single entity providing monopoly services. To assure "full and fair" competition, we therefore urge the Congress to maintain that environment and take care not to stifle albeit unintentionally existing competitive forces. In our industry, the maintenance and furthering of competition requires special treatment to prevent AT&T, Comsat and Western Union from utilizing their historic monopoly advantages to the detriment of the present carriers as well as new entrants.

INDUSTRY STRUCTURE

Before proceeding to specific analysis of the bills before this Subcommittee, I should like to survey the international telecommunications environment, including the role Western Union might be expected to play. This survey will be useful in pointing out the substance of our concerns.

The U.S. international telecommunications industry consists of three major segments.

First, there is AT&T which provides all international voice telephone services to and from the U.S. Mainland as an extension of its domestic telephone service monopoly. AT&T's annual revenues from international telephone service, excluding Canada and Mexico, are over \$800 million.

The second segment of the industry consists of carriers providing international record services, including RCA Globcom, ITT World Communications Inc., TRT Telecommunications Corp., Western Union International, Inc., FTC Communications, Inc. and also Hawaiian Telephone Co.¹ These carriers provide services such as telegrams, telex, facsimile, data transmission and leased (private line) channels for voice/data communications between the U.S. and overseas points. Annual revenues for this segment of the industry are approximately \$450 million.

The international record carriers at present only serve the public directly in five designated "gateway" cities in the continental U.S. At these points, they solicit business directly and interconnect with domestic carriers, primarily Western Union, for the pickup and delivery of their traffic to U.S. points beyond the gateway cities (referred to in industry parlance as the "hinterland"). To the extent additional competitors are allowed in, they will be seeking to serve basically this segment of the international communications market.

Comsat forms the third major segment of the U.S. industry. It has enjoyed a privileged position due to its quasi-governmental status. Pursuant to the Communications Satellite Act of 1962, Comsat was created and given sole U.S. responsibility for participation in the ownership of the global communications satellite system contemplated by that Act. It is the only American communications entity presently entitled to deal directly with INTELSAT and has recently been given a newly-expanded monopoly in INMARSAT. Comsat also is the sole provider of AT&T's Comstar domestic satellite system and is a partner in IBM's proposed domestic satellite venture.

AMERICAN TELEPHONE AND TELEGRAPH

AT&T is the largest corporation in the world. It totally dominates the domestic and international voice market. If AT&T were allowed to provide international non-voice communications service, it would, because of its inherent advantages, inevitably dominate the entire international telecommunications market. There is no practical way to curb AT&T's monopoly advantages and therefore we agree with S. 611 that AT&T should not be allowed to expand its monopoly into the international record market.

At present, AT&T's monopoly telephone service accounts for approximately two-thirds of the total international communications market of about \$1.2 billion annu-

¹ U.S.-Liberia Radio Corporation, a subsidiary of the Firestone Tire and Rubber Company, also provides certain overseas record services.

ally. The goal of "full and fair" competition cannot be achieved if AT&T is allowed unfettered access to the remaining one-third of the market which now not only sustains all of the other existing carriers, but would presumably be expected to support new market entrants as well.

Since 1964, in recognition of its monopoly position, AT&T has not been authorized to offer new non-voice communications internationally. AT&T's ability to dominate the entire international telecommunications market, both voice and record, would be further enhanced by its domestic monopoly position. For example, AT&T could use the facilities of its domestic message telephone monopoly to exploit international dataphone service. Due to this and the international record carriers' inability to obtain interconnection to these monopoly facilities on an equivalent basis along with AT&T operating companies, AT&T's service would have an overwhelming and unfair competitive advantage.

We believe the prohibition against AT&T entry into international non-voice telecommunications contained in S. 611, Section 252(b), should be clarified to prevent the provision of such service by AT&T through an affiliate or subsidiary.

The present language of S. 611, however, may go farther than is necessary to carry out its purpose of placing a check on AT&T's monopoly power in the international area. Thus, the bill flatly prohibits any "international telecommunications carrier which provides international public message telephone service for which it is not subject to effective competition" from also providing "any other international telecommunications service."

Taken literally, the applicable language could apply to RCA Globcom because it provides telephone service between Guam and foreign points. Guam telephone service with foreign points provides less than one percent of our operating revenues.

We believe that a minor amendment to S. 611 restricting the applicability of this provision to carriers which "predominantly" derive their overseas revenues from basic telephone service would deal with the specific problem of AT&T, while not placing an unintended hardship on smaller, non-monopoly carriers.

In sum, AT&T's entry into the international non-voice market would expand its already enormous power and make real competition impossible.

WESTERN UNION

We have in the past supported proposals which recognized the competitive imbalance resulting from Western Union's monopoly posture in the hinterland markets by precluding Western Union from operating internationally for five years. While Western Union has been permitted to exploit its domestic monopoly, and develop its markets virtually free of competition for 35 years, the international carriers have been confined to five U.S. cities. Efforts to change this situation have been stalled at the FCC for over seven years. At present, more than half of all international record traffic originates or terminates in the United States on Western Union facilities.

Immediate entry would provide Western Union with an opportunity—which it would have every reason to use—to take unfair advantage of its domestic monopoly position over telex and TWX services and divert the vast majority of international telex traffic to its own facilities. This would result in RCA Globcom being deprived unfairly of the bulk of its traffic and revenues from the hinterland.

Telex is the mainstay of the international record communications industry. Given Western Union's substantial and unearned headstart, as a practical matter, it will take considerably longer for the international carriers to establish themselves in the hinterland than it would take Western Union to make the requisite operating arrangements to enter the overseas market.

First, it will be necessary for the international carriers to build and develop appropriate nationwide domestic distribution systems. This task cannot be accomplished in a few months or even a few years. On the other hand, we would anticipate that Western Union could, in a relatively short period of time, negotiate the necessary contracts and obtain the facilities to operate directly with the principal foreign administrations.

Second, it should be noted that Western Union presently has over 120,000 subscriber installations on its nationwide domestic telex and TWX networks compared to RCA Globcom's approximately 7,000 installations in only five cities. Thus, Western Union's existing customer base is more than 17 times our size.

Immediate Western Union entry would imperil the large investment in facilities and plant made by the international carriers in reliance on present law.

Under the circumstances, in order to assure "full and fair" competition, we believe the international carriers must be afforded a reasonable opportunity to overcome Western Union's advantages which were not earned in the marketplace, but rather are an outgrowth of legal and regulatory conditions in existence for more than three decades.

We believe these general proposals to be consistent with the concern expressed by Chairman Hollings in introducing S. 611 that unrestrained entry by telecommunications monopolies into competitive markets could create a climate where "full and fair" competition would not be possible. As stated by Chairman Hollings, the Congress "cannot ignore the overpowering presence of integrated monopoly carriers . . . which could hinder entry into many if not most telecommunications markets because of their size, market presence and because they control access to the existing network."

We believe that these matters should be dealt with specifically in statutory language, rather than be left to regulatory interpretation. As a result, we support those provisions of S. 611 which would appear to limit AT&T to basic telephone service internationally and end Comsat's present monopoly of international satellite facilities. However, we do not believe that either S. 611 or S. 622 adequately deals with the special problems presented by Western Union.

We therefore believe that appropriate amendments should be made to preclude Western Union from entering the international record market for a period of at least five years, or until such time as the FCC finds, on an appropriate record, that effective competition exists with Western Union in the domestic transmission of international telex traffic in most of the country.

COMSAT

If the approach contained in S. 611 is not adopted, then provision must be made to deal with Comsat's international satellite monopoly. When Congress provided for the creation of Comsat and gave Comsat its present U.S. monopoly control over access to the international satellite facilities, this was done with the understanding that Comsat would not offer service directly to the public, except in unique circumstances. No need has been shown to alter Comsat's present role as a carriers' carrier.

Allowing Comsat to expand from a monopoly base will not serve the best interests of this nation. Rather, the creation of such an industry structure brings with it real dangers to the maintenance of a competitive market.

Comsat is the monopoly provider of satellite facilities for both international and maritime services. It further enjoys special privileges as a quasi-governmental entity created pursuant to an Act of Congress. Comsat is the only U.S. communications entity with a federal charter, three government-appointed directors and reporting at least annually to the President and Congress. As noted, Comsat is the sole provider of AT&T's Comstar domestic satellite system and is a partner in IBM's proposed SBS domestic satellite system. Thus, Comsat will have substantial interests in two domestic satellite systems through its alliance with IBM and its monopoly lease to AT&T, and will still retain its INTELSAT and INMARSAT monopolies.

RCA Globcom believes that various Congressional and FCC proceedings have made clear that Comsat's primary mission is to discharge its responsibilities as the U.S. representative in INTELSAT and INMARSAT and that appropriate steps should be taken to assure that this mission is fulfilled. Certainly, there can be little doubt that it was intended that these functions should take precedence over Comsat's involvement in the commercial sector of the communications market which is adequately being served by the common carriers.

Any new legislation should not allow Comsat both to act as a carriers' carrier and to provide international telecommunications services on a competitive basis directly to the public. If the latter approach is adopted, Comsat should not be allowed to retain its monopoly position as the sole owner of the INTELSAT facilities and the proposed new INMARSAT system.

The creation of a separate subsidiary would not prevent cross-subsidization between Comsat's wholesale and retail functions. Indeed, more rather than less, regulation would be required to monitor the Comsat parent-subsidiary relationship. As a practical matter, it is unlikely that even such a new layer of regulation would solve the problem. If Congress desires to change the status of Comsat, we submit that it must also end Comsat's monopoly position.

In the event Congress permits Comsat's entry into the retail international record market, this legislation should at the same time afford the international record carriers, the opportunity to compete with Comsat on a relatively equal footing. This could be done by authorizing the international carrier to acquire satellite facilities on economic terms equivalent to those which Comsat receives.

For example, the international carriers could be permitted to acquire indefeasible right of user (IRU) interests in satellite circuits from Comsat on terms which would not affect any existing treaties or at a lease price that reflects INTELSAT utilization costs only and perhaps a ministerial fee to cover Comsat's administrative costs, an approach endorsed by the Department of Justice and NTIA. While this will not

cure the problem caused by allowing Comsat expansion, absent such action, Comsat would have a decided and unfair competitive advantage.

INTERNATIONAL FACILITIES OWNERSHIP AND USE

S. 611 and S. 622 adopt divergent approaches to facilities planning. S. 622 essentially directs the FCC to adopt a procedure calling for consultation with the carriers to develop policy guidelines in advance and then allowing the carriers to negotiate a facilities plan with their correspondents in accordance with the guidelines. However, as noted above, should the proposal contained in S. 622 or a similar one be adopted, measures must be included to prevent Comsat from taking advantage of its satellite monopoly to defeat the purpose of this legislation to foster meaningful competition.

S. 611 adopts the concept of having all international transmission facilities—both cable and satellite—owned by the international carriers in proportion to relative use. Provision for ownership of both major types of overseas transmission facilities by U.S. carriers would eliminate or appreciably reduce the controversies over cable versus satellite use which have occurred in recent years.

We support the principle of ownership of facilities related to use, but believe the provisions of S. 611 should be amended to avoid certain ancillary, but adverse, consequences. While we agree that there are difficulties with the present system of planning international facilities, the concept of S. 611 would be significantly improved in our view by a change in its underlying—and erroneous—working assumption that there is no effective competition among U.S. carriers providing international telecommunications. We believe the ownership concept in S. 611 should be modified in accordance with the following basic principles.

S. 611 establishes a new International Facilities Management Corporation which would plan and manage the facilities used by the carrier owners. As presently proposed, the carriers whose facilities would be taken by the "consortium" and managed by the Corporation are deemed noncompetitive (or "Category II" carriers). As a consequence, they are not only denied an effective voice in the governance of the Corporation, but could be effectively precluded from dealing with their customers except through separately-created domestic subsidiaries. S. 611 simply imposes too many unnecessary practical penalties to serve its objectives.

The governing body of the Corporation is now set up in such a way that the international carriers, which will use the facilities and be required to put up all of the investment, will have only a minority voice in the Corporation's affairs.

We believe that the proposed composition of the Board does not provide adequate representation to the international industry as a whole which has the experience and the responsibility for serving the public. We recommend as an alternative that all participating international carriers be represented on the Board and that decisions be by a vote weighted so that all the international carriers collectively would form a majority, with appropriate provisions so that no single carrier could dominate the Board.

Under the present arrangements in S. 611, two-thirds of the Board would be chosen by parties with no direct financial stake in the activities of the Corporation and no responsibility for the provision of international service. Indeed, since Government agencies such as the Defense Department and NASA are among the largest users of international communications, almost half the Board could come from outside the private sector. RCA Globcom believes this is contrary to what we understand is Congressional policy to decrease rather than increase Government involvement in business.

We also do not believe that the public interest will be served by allowing non-carrier entities to interconnect their systems at the cablehead or earth station. Were such arrangements to be permitted, only the largest users could take advantage of them. The resulting diversion of revenue from the common carriers would create additional pressures for rate increases services provided to the smaller users who can least afford it.

We accordingly believe that the public interest would be better served by continuing present policy which gives the same treatment to all users—large and small. This view, is, furthermore, consistent with the legislative history of the Communications Satellite Act where Congress addressed a similar problem. Thus, the then Chairman of the FCC testified that if the public could go directly to the Corporation for service, this could "result in a considerable loss of revenue to the carriers and impair their ability to provide adequate service to the public."²

² Hearings on S. 2814 before the Senate Committee on Aeronautical and Space Sciences, 87th Cong., 2nd Sess. at p. 65 (1962).

In some ways, S. 611 appears to impose more onerous burdens on the competitive international record carriers than on monopoly carriers such as AT&T. In its practical effect, S. 611 could cause a radical and unnecessary restructuring of the industry, potentially enabling dominance by one or two favored entities, and threatening the viability of the international record carriers. We could be required to transfer our facilities to a consortium in which we might not have any meaningful voice and to change in other fundamental respects the manner in which we have long conducted our business. For example, we could be removed from direct contact with our customers by being compelled to turn over international traffic we presently handle ourselves to domestic carriers and prevented from continuing to offer communications equipment to customers as part of a total service.

To a certain extent, we believe that this proposed restructuring may be the consequence of a basic misunderstanding of the competitive nature of the international industry. This is especially disturbing given our existing commitment to competition and our willingness to fund and develop new and innovative programs, such as international Q-Fax service and other advanced data services.

CLASSIFICATION OF CARRIERS

The international record carriers are presently subject to active and keen competition. We therefore fail to understand the presumption in S. 611 that we are "noncompetitive."

Our industry derives no significant revenues from monopoly services. It consists entirely of relatively small companies none of which dominates the market. Indeed, the international record carriers are—and have been over the years—the most competitive segment of the U.S. communications industry.

It should be borne in mind that competition exists in service as well as in price. Virtually every significant improvement in the record service area has resulted from the competitive efforts of carriers such as RCA Globcom rather than from the domestic telegraph monopoly. We introduced international direct distance dialing for telex long before it was available on the overseas telephone network and have employed computer technology to provide such service enhancements as one-digit dialing, store-and-forward capability and automatic retry procedures when a call cannot be completed immediately.

Our industry also has engaged and continues to engage in active price competition. As a result of existing competition, numerous reductions have been made in the rates for overseas private line (leased channel) services. Rates for overseas telex calls have been steadily declining, while rates for comparable domestic services provided by Western Union are being increased.

In view of the number of carriers which already participate in our industry, in addition to those now seeking entry, we believe that it is clearly inappropriate to classify the international record carriers as "noncompetitive" and thereby subject them to regulatory requirements primarily intended to prevent abuses of monopoly power. In the interest of maintaining the thrust of the bill to encourage competition, it seems to make little sense to restrain the activities of the international carriers in the marketplace in the same manner as monopoly carriers.

Certainly, the fact that a carrier has been mandated to transfer its facilities to a single entity should not by itself determine its regulatory status as a Category II carrier. If it is competitive in the marketplace, it should be treated as such.

The arbitrary, and we believe unjustified, classification of the international record carriers as noncompetitive would, under S. 611, apparently automatically cause any domestic carrier affiliated with an international carrier also to be regulated as if it were a noncompetitive carrier and require it to petition the FCC for designation as a Category I carrier. The FCC's determination is essentially left to its discretion without precise statutory guidelines. The failure to obtain a Category I designation would place domestic affiliates of international carriers at a decided disadvantage in competing with domestic carriers which are essentially unregulated because they do not have any affiliation with an international carrier. Thus, S. 611 could in practice inhibit rather than expand the competitive provision of communications by non-monopoly carriers in both the domestic and international markets.

The important point, we believe, is that all non-monopoly carriers should be treated the same, i.e., either regulated or substantially deregulated. "Full and fair" competition will not result where one group of competitive carriers providing functionally equivalent service is subject to more burdensome regulatory requirements than another.

The classification of the international record carriers in Category II also carries with it other constraints which would fundamentally and adversely affect our present business. For example, S. 611, in Section 203(c), casts a cloud on our ability to offer telecommunications equipment as an integral part of a telecommunications

service. Such a provision could bar the international carriers from continuing to provide telex terminals and other communications equipment to their customers. This action would change the manner in which international telex service has been provided from its inception some 25 years ago; lead to the premature write-off of substantial investment in communications equipment by the international carriers; and, most importantly, result in higher charges and/or reduced service to a majority of the present telex customers of the international record carriers. These customers are in the main the smaller users. We are not sure this result was intended and would be pleased to work with your staff on clarifying language.

SEPARATION OF SERVICES

As noted, RCA Globcom supports the provisions of S. 611 intended to limit AT&T to the provision of basic telephone service in the international market. However, we have reservations about the requirement in Sec. 252(a) of S. 611 that every carrier providing both domestic and international telecommunications services must establish a fully separated entity for the provision of either its domestic or its international services.

We are particularly concerned that this provision, taken together with the interconnection requirement in Sec. 251(a), could be construed as requiring the international carriers to serve the public in the U.S. solely by means of interconnection with domestic carriers. While such a limitation may be appropriate for AT&T, we submit that it should not be extended to the far smaller, competitive international record carriers.

First of all, insistence that the international record carriers serve their customers for international services, as opposed to purely domestic services, only by means of interconnection with domestic carriers would seem inconsistent with the intention of S. 611 to repeal Sec. 222 of the present Act.

Second, and more importantly, if this construction were adopted, the international carriers would lose all direct contact with their customers. This, we submit, would be contrary to the bill's primary purpose to promote "full and fair" competition. In a competitive environment, it is absolutely essential for a carrier to maintain direct customer relationships. As the FCC has had occasion to note, the present direct interplay between the international carriers and the public serves a beneficial purpose by keeping the carriers responsive to public need.

INTERCONNECTION

RCA Globcom would be willing to interconnect on appropriate terms with all domestic carriers, assuming that we may also continue to serve our own customers directly as well. We believe that this approach will substantially meet the objectives of S. 611 to encourage competition in the domestic market. However, mandating interconnection among non-monopoly carriers in direct competition with one another would not be in the public interest.

S. 611 imposes essentially the same mandatory interconnection requirements on the competitive international record carriers as it does on AT&T and other telephone monopolies. We believe that this is unwarranted given the competitive nature of our industry and the relative size of the participating carriers.

It is our position that compulsory interconnection and competition are basically inconsistent as applied to competing carriers which do not provide monopoly services or enjoy special advantages. On the other hand, carriers such as AT&T and Western Union should be required to furnish upon request and on nondiscriminatory terms appropriate interconnections to other carriers for their services. As noted, we would be prepared to do the same for domestic carriers for the handling of traffic destined to or from overseas points.

ALLOCATION FORMULA

S. 611 proposes that a distribution formula be established by the FCC to allocate international traffic in the inbound direction from overseas among domestic carriers in proportion to their share of all competitively-derived traffic originating within the U.S. destined to overseas points. As we understand it, this provision is intended to assure equitable treatment of connecting domestic carriers.

We believe that a rigid allocation formula would be unduly burdensome; difficult and costly to administer; and require complex interconnection and switching arrangements. It also could have a disruptive effect on present international arrangements with respect to the routing of traffic destined from the overseas communications systems to the U.S.

The allocation formula proposal further fails, we believe, to give due allowance to the manner in which most types of international traffic are handled in practice. For example, like a telephone call, an inbound telex call from overseas is routed to a

specific called party's number either on our own system or the system of a domestic carrier. The call therefore ultimately has to be transferred to the facilities of the carrier to which the called party in the U.S. is connected. This factor substantially restricts—and in many cases prevents—such traffic from being “allocated.”

We therefore believe that the bill should be clarified, at the very least, to limit the effect of any proportionate return requirement to inbound unrouted traffic only. An alternative approach to be considered would be to revise the formula to provide that the domestic carrier should allocate to the international carrier outbound traffic destined overseas in proportion to the amount of inbound traffic from overseas turned over to the domestic carrier.

We further are concerned that the premise of the formula appears to be the assumption that the international carriers will not be allowed to continue to serve their customers in the U.S., except by means of interconnection with domestic carriers. As previously noted, such a situation in our view would not promote competition, but rather would take away competitive alternatives now available to the public.

FCC FEES

We do not agree with the “market value” concept for determining FCC fees reflected in S. 611. Among other things, the effect of the approach to setting fees in S. 611 would be to impose an additional special tax on communications entities. To the extent any fees are mandated, we believe the approach contained in S. 622, namely that fees be designed to recover the cost attributable to regulation, to be preferable to that in S. 611.

CONCLUSION

What is of concern to us here is the viability of the international record carrier industry in a market environment where others are free to manipulate statutorily granted advantages or to exploit existing monopoly status. Such so-called “competition” would not produce the public benefits you seek.

We also think that S. 611 has not adequately recognized the genuine competition which exists and will continue to exist at the U.S. terminal. I have pointed out to you today various examples of that competition which have benefited the public in terms of better service and lower rates. Certainly, concern over the present manner in which international facilities are authorized, constructed and utilized should not override the many other factors which bear upon the rendition of international service.

As set forth earlier in my testimony, the problems presented by the present method of authorization and use of overseas facilities are not insoluble. Rather, they can and should be addressed with a minimum of structural change and with the objective of maintaining the competitive environment in the international record industry, which is the only area of telecommunications not presently dominated by monopoly carriers. As we have pointed out, this objective can be accomplished in a manner completely consistent with the competitive aims of these bills.

The international record industry is serving the public well. We believe it would be unwise to permit the development of policies which could radically change this industry or enable carriers providing protected monopoly service to exploit this advantage and unfairly expand into a limited market where there is already active competition.

We believe it is in the public interest to continue to foster an economically sound international telecommunications industry which has provided innovative, technologically-advanced and cost-effective service. We therefore urge that the proposed legislation be appropriately modified in accordance with the recommendations contained herein and would be pleased to work with the Subcommittee and its staff to this end.

Thank you.

Senator HOLLINGS. Thank you.

Dr. Charyk?

Dr. CHARYK. Mr. Chairman and members of the Subcommittee on Communications, I am Joseph V. Charyk, president and chief executive officer of the Communications Satellite Corp. I am especially grateful for this opportunity to testify with respect to S. 611 and S. 622 because of their significance to Comsat. My oral comments today will be addressed principally to part two of S. 611—International Telecommunications. This section seems to propose

major and drastic changes in structure and policy on the international side, changes which will severely and adversely impact on the cost and quality of international communications services to the U.S. consumer. Such radical changes appear to be in striking contrast to many of the observations relative to the overall philosophy of the bill. In this respect, I have a far more favorable reaction to S. 622 which seeks to address the problems which have been noted such as, for example, procedures for international facilities planning. Here S. 622 seeks to codify a more formal process for dealing with such matters rather than undertake a wholesale restructuring of our industry and processes.

I would like to begin by noting that I view the major objectives of S. 611—to increase competition and to improve planning in the international telecommunications field—as desirable overall goals. Unfortunately, I believe the bill, as structured, will not achieve those objectives.

In fact, I believe the effect of S. 611 will be to lessen competition rather than promote it, because intermodal competition between satellites and cables will be submerged and Comsat, the one entity dedicated solely to the furtherance of satellite technology, will be virtually eliminated from the scene. I believe the restructuring of the international telecommunications industry contemplated by S. 611 will rekindle the controversy that has now substantially subsided in connection with the planning, construction, and operation of international telecommunications facilities, because the existing, established relationships between the carriers and their foreign correspondents, and between Comsat and its Intelsat partners, will be destroyed and new ones will have to be established by what is likely to be an ineffective and ambivalent, nonprofit facilities management corporation.

Let me summarize briefly what I view as several of the most startling provisions of S. 611. First, the proposed structure of a nonprofit management corporation and a separate facility-owning consortium is, in my judgment, unrealistic. Divorcing ownership and management in the way proposed is, I believe, a sure prescription for failure. It is an incredible situation indeed where the manager would neither be responsible for the investment nor for the quality of services to the end-user, and where the owners would be subject to the manager as S. 611 seems to contemplate.

Second, the international telecommunications market is substantially different from the domestic market, and competition cannot be achieved by unilateral legislative fiat. There are very large barriers to entry into the international market, and A.T. & T.'s message telephone service, representing nearly 80 percent of the market, is virtually impregnable because of its domestic telephone and long lines monopolies, and its foreign operating agreements and correspondent relationships. Thus, any competition that may arise would only be for a portion of the remaining 20 percent of the market. Here the three large record carriers, RCA, ITT, and WUI, are also substantially entrenched.

Thus, while the bill purports to open the way for veritable cadres of U.S. carrier entrants, in fact the opportunities for entry will be little different than under the existing industry structure. The key both today and in the future under existing or new statutory

provisions is the willingness of foreign entities to enter into operating relationships with new U.S. entrants. Under the current procedures, the FCC at least has an opportunity, through its licensing of new facilities, to bring pressure to bear on the foreign entities along these lines. S. 611, on the other hand, provides the foreign entities with a splendid opportunity to pick and choose which U.S. carriers they will interconnect with, as may be in their best national interest, and thereby to exert greater influence over the provision of international communications services within the United States at the expense of the U.S. consumer.

Third, in the interest of encouraging competition in what realistically is limited to only about 20 percent of the U.S. international market, S. 611 would dispense with the far more meaningful competition that now exists, namely, the intermodal competition before the FCC between cables and satellites. As I indicated in my written testimony, this competition has spurred both sides on to making large-scale advances in communications capacity and to corresponding decreases in the unit cost of international communications, with obvious benefits to consumers.

Fourth, it is somewhat ironical that the other major objectives of the international portion of S. 611 is to improve planning in the international telecommunications field, since I believe that events over the past year indicate that the parties involved have already reached agreement upon the necessary improvements in that process. In fact, a master plan for transatlantic facilities implementation and use through 1985 has essentially been agreed upon, and, more importantly, the United States, European, and Canadian telecommunications entities are now engaged in a facilities planning undertaking that goes through 1995. This effort will employ new planning processes and procedures which bring together both the cable and satellite planners and operators on both sides of the ocean at an early stage. Rather than being shunted aside as S. 611 would do, these new planning processes should be given every opportunity to succeed.

In my remaining few moments, I want to turn to the subject of the very severe, adverse consequences S. 611 would have for Comsat. By substantially changing Comsat's primary role as a carrier's carrier to that of a theoretical full competitor in the marketplace with A.T. & T. and other carriers, and by making ownership in the facilities ownership consortium dependent upon use, Comsat's effective participation in that consortium, and thereby in the operation of satellite facilities, is eliminated overnight. Comsat has traditionally been limited to being a carrier's carrier—a wholesaler—and thus has no end-user customer base, no internationally deployed marketing staff, and no foreign correspondent relationships. While it is possible that Comsat could nonetheless make some inroads into a portion of the IRC's market share, this added competition from Comsat would be insignificant in the larger scheme of things by virtue of A.T. & T.'s monopoly.

The bill would take away Comsat's role in Intelsat, which we helped to create. The bill would take away Comsat's international facilities—about 25 percent of all U.S. international communications facilities—and permit us, on the basis of usage, to acquire only a 1 or 2 percent interest in the new facilities ownership

consortium. The bill would bring to a sudden halt Comsat's revenue stream from our established international business and leave us with a one-time payment, to be decided by an arbitration panel, for our facilities, but not for our loss of business or future potential. Finally, the bill would cause inestimable damage to Comsat as the U.S. commercial flagship in space, if it did not destroy it altogether and disperse its small but highly effective staff, an asset that cannot be replaced.

Mr. Chairman, one other asset that is irreplaceable in my estimate is the credibility of Congress, and I believe that is at stake here. More than half of Comsat's current shareholders are individuals who purchased our stock in 1964, encouraged by Congress to make an equity investment in the future of space technology. It is true that no guarantees were given those investors by the U.S. Government and that they were well aware that there were significant business risks involved, but I believe the implication was clear that, given success of the business, they would have made a good long term investment. I cannot believe that any of those investors were aware that one of the risks they were taking was that, once the global satellite system achieved technological and business success, it would be taken away from Comsat by the Government that had set the policy and encouraged their participation in the first instance. This is a bitter anachronism, particularly since, by any standard, the development of a global communications satellite system through the pioneering efforts of Comsat has been an outstanding success. One hundred and two nations are now members of Intelsat and each contributes to its share of all of the investment, research, and development costs. This system, pioneered by Comsat, provides service to 132 locations through 674 satellite paths, an unprecedented accomplishment in a cooperative international undertaking that represents the most successful international joint venture ever undertaken. This has all been accomplished without the investment of any U.S. Government funds and has been made possible through the private investment of over 100,000 shareholders. Given this history, if S. 611 is enacted, it would be very difficult indeed, if not impossible in my judgment, to get the American public with private funds to underwrite any similar venture again.

Interestingly enough, two proposals of that nature are before Congress at this time. Senator Schmitt of this subcommittee and Representative Fuqua, Chairman of the House Committee on Science and Technology, have introduced bills to create an Earth Resources Satellite Corporation and a Space Industrialization Corporation, respectively, patterned on the Comsat model. If S. 611 becomes law, financing such ventures with private capital would be, I believe, out of the question.

Lastly, the drastic approach of S. 611 would require a massive upheaval in the international telecommunications industry, with great uncertainty as to the outcome, and great potential for damage to the public. In the spirit of evolution rather than revolution, I prefer the approach to international communications taken by S. 622. That bill would codify the existing framework for international facility planning, and would give the recently improved international planning process an opportunity to succeed; given the

chance, I am confident that it will. I would also like to strongly support a very important provision in S. 622, section 226(g), dealing with effective representation of U.S. interests at international telecommunications meetings. In view of the critical nature of many international telecommunications meetings forthcoming in the very near future, I believe it to be very important that such legislative action be implemented.

Mr. Chairman, this concludes my oral statement. I would be glad to answer any questions you or the other members of the subcommittee may have.

[The statement follows:]

STATEMENT OF DR. JOSEPH V. CHARYK, PRESIDENT AND CHIEF EXECUTIVE OFFICER OF COMMUNICATIONS SATELLITE CORP.

Mr. Chairman and members of the Subcommittee on Communications, I am Joseph V. Charyk, President and Chief Executive Officer of the Communications Satellite Corporation. I am especially grateful for this opportunity to testify with respect to S. 611 and S. 622 because of their significance to Comsat. My comments today will be addressed principally to Part Two of S. 611—International Telecommunications. At the end of my discussion, I will devote a few comments to S. 622 which has the effect of codifying a more formal process for the conduct of international facility planning, obviously a desirable objective.

I would like to begin by noting that I think the major objectives of the bill—to increase competition and to improve planning in the international telecommunications field—are desirable overall goals. Unfortunately, not only do I not believe the bill, as structured, will achieve those objectives but I believe that the bill, will have serious and far reaching deleterious effects on international communications, on U.S. prestige and on the quality and cost of communications services to the one who really counts—the U.S. consumer and ratepayer. My reasons follow.

First, I think the bill's effect will be to lessen competition rather than promote it because it will result in the industry being dominated by the four major international carriers. I think it is clear that is not the intent of the bill. I also think it will rekindle the controversy that has substantially subsided in connection with the planning, construction and operation of international telecommunications facilities, at least for the 1979-1985 period.

Second, the bill will have a substantial adverse effect on the prestige and leadership role that the United States has been able to acquire and maintain in the development of both satellite and cable technology. Over the past 15 years, largely through the application of U.S. technology and the guidance of Comsat, as the representative of the U.S. in Intelsat, the design capacity of an individual satellite has risen from 240 voice circuits in the Intelsat I satellite to over 12,000 in the Intelsat V satellites to be delivered late this year. Spurred by this development and growth in satellite technology, the design capacity of an underseas cable has increased from 138 voice circuits in TAT-4 to 4,000 in an SG Cable such as TAT-6. We are concerned that such developments will be markedly reduced if the decision-making process that exists today, which includes regulatory review, were replaced by a loosely managed generally unregulated non-profit corporation and a discordant array of carriers, as contemplated by the bill.

Third, the cost and quality of international telecommunications will, we fear, be dealt a harsh blow by the enactment of this bill. The demand for all forms of high quality international communications, both voice and record, is on the rise and, as previously indicated, the design capacity of both cables and satellites have increased markedly over a fairly short time interval to meet that demand. Rates for most international services have also been tumbling down.

In 1964, prior to the advent of commercial satellite communications services, the U.S. carriers' rate for a leased voice-grade cable half-circuit between the U.S. and Europe was \$10,000 per month. When satellite service was instituted to Europe in 1965, at a rate of \$4,200 per half-circuit, the U.S. carriers switched to a "composite" rate for both cable and satellite circuits, which was set at \$8,000 per half-circuit. In 1967, the satellite rate was reduced to \$6,000 per half-circuit. At the present time we are about to reduce the satellite rate to Europe from \$1,575 to \$1,340, and the composite rate is \$4,225.

Such progress has been made possible by the mechanisms provided for under existing law pursuant to which careful scrutiny is given, in a regulatory environment, to assure the high quality and reasonable prices of cable and satellite serv-

ices. The scheme contemplated by S. 611 will, we believe, be disruptive of such efficiency because it will lead to a loosely regulated series of multiple interconnections by multiple carriers with numerous duplication of facilities.

Fourth, I believe that the bill will subvert, if not destroy, the Communications Satellite Corporation and disperse its collective talents and experience. Thus, S. 611 will deprive the United States of the entity created by Congress and the Executive to spearhead our nation's commercial venture in space. There might be some support for such an action if it were clear that it was necessary to do so to accomplish the objectives of the bill. But, we perceive no basis for such an action where the emasculation of Comsat will not contribute in any way to the attainment of the bill's objectives.

Let me elaborate on these views and conclusions in the context of the stated major objectives of S. 611 with respect to international communications. These objectives are: (1) to enhance competition in the provision of the U.S. portion of international telecommunications services; and, (2) to assure that the views and interests of the U.S. in international telecommunications activities are represented more cohesively and effectively. To accomplish these objectives, S. 611 proposes a radical restructuring of the international telecommunications industry.

First, S. 611 creates a new, non-profit corporation to plan, manage and operate all U.S. international communications facilities except those used for maritime services. In that respect, it displaces Comsat from its statutory role in international satellite operations and AT&T from its traditional role in international cable operations and looks to a new corporation for both. Significantly, the new facilities operating corporation will have neither communications management experience nor a profit motivation.

Second, the bill separates facilities planning and management from facilities investment and ownership, the ownership being vested in a new consortium of transmission carriers. This represents a very unusual approach to the effective operation of a very complex service enterprise. We find it difficult to believe that either operating efficiencies or the best interests of the ratepayer will be served by forcing a separation of investors from an independent manager, particularly where there is no profit incentive.

Third, the bill requires the establishment of many new separate entities for the provision of both domestic and international telecommunications services. The organizations responsible for providing communications services directly to U.S. customers are to be insulated from the organizations responsible for the international transmission of U.S. communications traffic. In turn, the transmission organizations are to be insulated from the organization which plans and operates the international transmission facilities. Furthermore, it is not entirely clear under the provisions of the bill whether the marketing organizations or the transmission organizations, or both, will be expected to enter into foreign correspondent relationships with the fully integrated telecommunications entities in each foreign country. What is clear is that S. 611 creates a tangled, many layered web of U.S. communications companies engaged in handling the several segments of U.S. international communications. Quite frankly, we don't see how this fragmentation of the industry either can be thought to enhance the cohesiveness and effectiveness of U.S. representation in international telecommunications or as to how any assurance that the Subcommittee's goal of increased entry will be achieved by the bill. More likely it will lead to a deterioration of international telecommunications relationships and a degradation in the quality of international communications services.

Fourth, the bill will concentrate the ownership of U.S. international communications facilities in a manner that will dispense with the only meaningful competition that now exists in the international telecommunications field—namely, intermodal competition between cable and satellite facilities. Dissipation of that intermodal competition will tend to decrease, if not virtually eliminate, the motivation for technological developments that have brought both media—cable and satellite—increasingly available to the average user of communications services. In addition, this concentration of ownership will tend to skew the emphasis in future facilities toward cable technology because ownership will be concentrated in the existing international service carriers which have not only a traditional preoccupation with cables and operating agreements with similarly preoccupied foreign entities, but which in a number of cases also have cable manufacturing interests.

Fifth, in restructuring the industry, the bill gives rise to several anomalies—it turns the clock back seventeen years and provides the terrestrial international carriers with the control of satellite facilities that Congress rejected in 1962—and it does so by penalizing the individuals who Congress encouraged to invest in Comsat and by rewarding the terrestrial carriers with a significant financial windfall—namely, a second opportunity to buy the international satellite facilities and profit

from them. The anomaly, of course, is that each and every one of those carriers has already realized a significant profit from its original investment in Comsat.

In sum, we see the bill establishing a bifurcated, unbusiness like organizational structure to operate international communications facilities in an industry environment that has been made more, rather than less, complex. In addition, the industry environment will lack both intercorporate and intermodal competition as well as incentives for technological improvement and operating economies. Moreover, the restructuring will be conducted in a manner financially inimical to small private investors encouraged in the past by the Government to invest private capital in satellite communications, and financially beneficial to a few, super powerful international business corporations.

This is a bleak picture and, I suggest, a bleak prospect for the communications ratepayers. Before I elaborate on how I reach this very negative evaluation of S. 611, let me spend a moment on the two alleged problems that the bill is designed to solve. If we put these problems—and they are simply that, problems, not crises—in perspective, we may very well conclude, as I have, that they do not warrant the potential risks and costs of a radical restructuring of this industry.

The first is the problem of planning and implementing new international communications facilities. Recent years have highlighted the controversies between cable and satellite interests and, by some accounts, have witnessed dire consequences. This is a perception of the matter that I do not share. Present international communications services are better than ever and, in my opinion, just about as good and cost effective as current technology permits. There has been no failure to meet customer requirements either in terms of the quantity or quality of circuits available, and there have been no extraordinary international contretemps. The most that one can acknowledge is that the advocates for cable and satellite facilities, and the Government agencies charged with responsibilities in connection with making decisions concerning such facilities, have had to spend some time, and endure some frustration, in airing the various conflicting views involved. After normal give and take negotiations, however, most of the problems have now been solved.

A Master Plan for facilities implementation and use in the 1979-1985 period is nearing completion. With minor exceptions on two routes that are being worked out, the new Plan has the full agreement of Comsat, the U.S. carriers, the FCC and the foreign correspondents. The Plan looks to implementation of the TAT-7 cable in mid-1983 rather than early 1981 as originally proposed, and allocates the projected growth over the entire period to individual cable and satellite facilities. Thus, the existing mechanisms and procedures have, for all practical purposes, produced an acceptable Master Plan.

On the basis of our prior experience, we are optimistic that the planning effort for the next cycle of facilities implementation for the 1985-1995 period between Comsat, the U.S. carriers, CEPT and the Canadian administrations, will proceed smoothly. Substantial progress already has been made on the development of improved two-tier consultative processes among these entities. Under all the circumstances, I would question the advisability of mandating a new and vastly more complex industry structure just at a time when a new, cooperative spirit among the disparate elements of the industry appears to be emerging, and where a codification of the planning process as reflected by S. 622 would be constructive.

The second problem S. 611 is designed to solve is the lack of intercorporate competition in international communications. The bill does not solve that problem. In fact, the bill would exacerbate the problem. In fact, the bill would exacerbate the present situation because, as previously indicated, the bill would eliminate the only true competition that now exists in this field—intermodal competition between cable and satellite facilities. While under certain properly designed circumstances, the advantages of intermodal competition might be outweighed by an effective single entity, we don't perceive that to be the case here. In order to be an effective instrument, the entity would in our judgment, have to be the U.S. participant in the ownership of all international communications facilities; it would have to be responsive to carriers' needs; and it would have to speak with one voice in dealings with foreign carriers. We don't believe the entity contemplated by S. 611 will do any of these things effectively.

For all practical purposes, the industry structure on both sides of the Atlantic makes significant, intercorporate competition impossible. In Europe, each nation has a single, governmental entity that serves telecommunications customers and owns and operates all of that nation's domestic and international communications facilities. For the foreign half of each transatlantic communications circuit, therefore, even the notion of competition is out of the question.

What about the other half—this side of the Atlantic? The fact is that AT&T's message telephone service utilizes about 78 percent of the U.S. international cir-

cuits. The traffic of the three large record carriers—ITT, RCA and WUI—utilizes most of the balance of the U.S. international circuits. I suggest to you that the small amount of competition which exists today would decrease rather than increase if this bill were enacted because of the change in the industry structure that will have to be made. Instead of having decisions made as they are today, by the integrated private sector under FCC review, under the new structure, separate layers of marketing, transmission, planning and operating entities will have to be established which, we feel, will introduce a major discordant element into the international telecommunications field. We are concerned that such a tangled industry web will impede competition, rather than promote it.

It may be true, as has been suggested, that new entrants can penetrate the existing customer bases and markets of AT&T, ITT, RCA and WUI, but I don't believe that a serious threat of their doing so is credible and I would be surprised if all new entrants together could occupy more than a few percentage points of the entrenched terrestrial carriers' carriers' markets in the foreseeable future.

I want to emphasize that I am not saying intercompany competition in this field is not a desirable goal; I am simply saying it is an unrealistic goal and I see nothing in the bill which would improve the situation. I believe this is true with respect to the marketing, collection and delivery of international communications within the United States, as well as with respect to international transmission as is recognized by Section 241 of the bill. Of course, intermodal competition is another matter, but I would like to deal with that subject at a later time. In the present context, I don't see true, incorporate competition as an achievable result in international telecommunications and I would not, therefore, establish it as a goal to justify a costly and risky restructuring of this industry.

In effect, then, while S. 611's objectives of increased competition and less international controversy are desirable, I am concerned that the bill will fail to meet those objectives and will, in addition, have a disruptive and adverse effect on the international telecommunications industry. Let me turn now to those disruptive and adverse consequences.

We believe S. 611 would make the industry more monolithic than it now is. As I indicated earlier, AT&T now utilizes about 78 percent of U.S. international circuits, cable and satellite. Its use is this substantial because of its virtual monopoly of U.S. message telephone service. In a similar vein, the major international record carriers, ITT Worldcom, RCA Globcom and Western Union International, utilize nearly the balance of U.S. international circuits. These companies' large share of the total market stems from their long established and their very extensive marketing organizations and their customer bases in non-voice traffic. These four companies also have, through long affiliation, firmly established foreign correspondent relationships. Comsat, by contrast, having been restricted to the role of a carrier's carrier—a wholesaler—almost from its inception, has no end-user customer base, no experience in, and no facilities for, retail marketing of services, and virtually no foreign correspondent relationships. We now own all of the U.S. share of international space segment facilities because Congress mandated that. If S. 611 becomes law, however, AT&T will own, through the new ownership consortium and by reason of its utilization of facilities, about 78 percent of both U.S. cable and satellite facilities and the international record carriers will own nearly all of the balance. Thus, S. 611 enhances, rather than ameliorates, the ownership position of these four giant corporations and permits them to purchase virtually all of Comsat's operating plant.

Comsat's objections to these prospective arrangements have been characterized as a failure to recognize a golden opportunity. The theory is that Comsat need only get out and market aggressively to achieve a reasonable share of the market and, thereby, a corresponding position in the new ownership consortium. Unfortunately, in view of the situation that exists today, we have no optimism at all that that is a realistic goal, particularly in the voice market.

With respect to the balance, if improvements were made in the tangled industry web referred to above, I think it is possible that Comsat could make small inroads on the IRC's and garner a few percentage points of the total market, but certainly no more than that, even given our continuing statutory monopoly of U.S. maritime traffic. In any event, only one fifth of the market on this side of the Atlantic is even open to competition in a theoretical sense, and the present occupants of that small portion of the market are quite thoroughly entrenched. According to recent reports, Southern Pacific Communications Company has made some small inroads on the AT&T voice traffic monopoly over the past five years, but the inroads are minuscule, relatively, and they have been made only through large capital investment and significant operating losses, both dependent on a parent corporation with a very deep pocket, a luxury Comsat does not enjoy.

Comsat has been, and remains, the principal driving force behind the continuing development of commercial communications satellite technology and services. Under S. 611, Comsat will have at best only a miniscule interest in the Ownership Consortium and no member on the Board of the Management Corporation. Moreover, it will no longer represent the U.S. on the INTELSAT Board of Governors. In effect, the U.S. "satellite spokesman" will have been emasculated. This will, we fear, lead to a significant deterioration in the continued growth and development of communications satellite technology and of the INTELSAT system. Such treatment of a corporation that is given dominant credit internationally for today's global network (high quality services and rapidly reducing prices) owned by many small investors who were encouraged by Congress to become involved on the basis of a national policy to proceed in this way would be shabby and unfair treatment to say the least.

AT&T and the record carriers, on the other hand, who will dominate the ownership consortium and the Management Corporation, together with their Canadian and European counterparts, will continue to have a strong cable bias. There are several reasons for this. First, AT&T, ITT and many of the European communications entities have cable manufacturing interests. Second, the devotion of these entities to cable technology is of long standing and both custom and inertia will have an impact on their attitudes. Third, since cable arrangements are predominantly bilateral, interests in cables will afford the owners greater control than they would have through a multilateral organization like INTELSAT. Fourth, since there is no commitment to have cable facilities serve the low traffic density areas around the world, as is true of the INTELSAT system, cables can be dedicated to high traffic routes, such as the North Atlantic basin, and have a greater profit potential than satellite facilities. The principal adverse consequence of this predictably increasing cable bias will be higher communications costs for many Americans as well as for the emerging nations of the world.

Lacking the continued presence of Comsat and an advancing satellite technology, there is another respect in which I would expect the ratepayers to be adversely affected. Comsat, for example, instituted a 48.5% rate reduction last August and recently filed a further 15% rate reduction to be effective May 16, 1979. Considering that this is a time of spiraling inflation and prices, I think Comsat's recent rate action is a noteworthy event. In this connection, I want to draw a contrast between Comsat and the other U.S. international carriers. While the 48.5% rate reduction I just mentioned did result from the settlement of a rate case instituted against Comsat by the FCC, the rates of the other U.S. international carriers appear to have been altogether unregulated. To the best of our knowledge, the rates of AT&T Overseas have never been investigated, and the last general rate proceeding for the international record carriers was completed in 1958, some twenty-one years ago. Early in 1976 the FCC took some preliminary steps with respect to the rates of AT&T Overseas and the record carriers, by instituting an "audit" of the carriers.

However, no action has been taken even though the audit has been completed. Finally, a more monolithic industry dominated by AT&T would result in a significant diminution of intermodal competition between cable and satellite facilities. I have no doubt that the emergence of satellite technology has accelerated the emergence of new cable technology, and probably vice versa, a benefit to the end user who has available to him facilities whose per circuit capital and operating costs are decreasing with technological innovation. Entrusting satellite technology to the effective control of the cable oriented carriers and their European correspondents will, I believe, ordain the atrophy of satellite technology and eliminate an important reciprocal motivation for continually more economical facilities to serve the U.S. public interest, as well as the U.S. foreign policy commitment to foster inexpensive communications on a worldwide basis.

I would now like to turn to another major adverse, or disruptive, consequence that I predict will follow the enactment of S. 611. The bill seeks an industry structure that will enhance rational decisionmaking, reduce the need for Government oversight, eliminate delays in the establishment of new facilities, and minimize international and domestic debate and controversy. Instead, I'm afraid I see the new structure as a legislative highway into a communications quagmire. Unfortunately, time does not permit me to go into all of the complex interrelationships mandated by S. 611 which lead me to this observation, but I will attempt to give you a few cogent examples and leave with you a chart we have developed which portrays graphically, but fairly, the unbelievably complicated interrelationships involved. (The Chart I refer to is attached as Annex A.)

One example of how S. 611 will complicate international arrangements is the bifurcation I mentioned earlier between the ownership of transmission facilities and the management responsibility for planning, constructing and operating them. If

one assumes, as I do not, but as the authors of the bill must, that AT&T will not dominate the Facilities Management Corporation, it would seem inevitable that an impasse will occur when the Managers of the Corporation propose plans for specific new facilities, and the major investors in the facilities consortium, who are the source of funds for the construction of new facilities, simply refuse to put up the capital for those new facilities. I won't dwell on the consequences of such an impasse because I believe the problem, if not the solution, is obvious. In any event, to exclude investor/owners from direct involvement in the complex negotiations that precede agreement with foreign administrations on new facilities is simply to invite delays and exacerbate controversy.

Another example of the quagmire I alluded to earlier is the fact that, subject to certain conditions, S. 611 opens the door for virtually every and any entity to become an international transmission carrier. The present transmission carriers can continue their roles if they establish separate subsidiaries for marketing their services domestically. Domestic interexchange carriers can continue their roles if they establish separate subsidiaries for international transmission carriage. Any private line owner and operator can engage in international transmission if it creates a separate subsidiary for doing so and enters into the required foreign correspondent relationship. We must stop and ask ourselves whether this can realistically do anything for the one forgotten person who really counts—the ultimate ratepayer or user of communications services. I believe this bill, if enacted, will lead to poorer service and increased costs. We should also ask whether this degree of proliferation will be accepted by foreign telecommunications entities, and whether it will really enhance competition.

Our view is that all of these questions must be answered negatively. I think we would be jeopardizing the operational integrity of a very efficient existing international communications system. Moreover, we know from experience that the foreign telecommunications entities are extremely reluctant to expand the number of their foreign correspondent relationships, and there is no way to force them to do so. Thus, I cannot conceive that the potential new entries contemplated by S. 611 will actually come to pass. The ultimate result will be that the "new open door" will not really be open, that Comsat will have been eliminated from the existing competitive structure, limited as that might be, and that the new industry environment will be sufficiently more complex and more confused to defy analysis.

As a final example of the adverse consequences I foresee from S. 611, I want to mention the regulatory environment that will exist—or, perhaps I should say—that will not exist. The bill appears to eliminate prior international facilities licensing, from what we judge will be a non-competitive environment, except for after-the-fact determinations of "... pattern[s] of mismanagement and/or imprudent investment" found on the basis of detailed factual hearings. Such hearings would be protracted and emotionally charged since they will involve allegations of mismanagement. The standard adopted by the bill for adverse determinations—namely, "patterns of mismanagement and/or imprudent investment"—is vague and untested by past precedent. And, the remedy—the subsequent imposition of a requirement of advance facility approval—is the most graphic case I have ever seen of closing the barn door after the horse has left. It is important to recognize that such a remedy can only be imposed after a protracted hearing is held and the Commission renders a decision and, most likely, after years of appellate review in the Federal courts. Meanwhile, literally hundreds of millions of dollars could be spent on facilities which may or may not be in the public interest. Therefore, if a prior public interest determination is to be abandoned, in the name of deregulation, such deregulation must be premised upon a competitive environment which will not exist under S. 611.

I could continue with other examples of the potentially adverse or disruptive consequences likely to flow from the enactment of S. 611, but it is essential for me to turn now to one final subject. That is, Comsat itself.

Under S. 611, all of Comsat's present INTELSAT related facilities would be purchased by the new facilities consortium. Comsat itself, having almost no end-customer usage, would be entitled to invest only a miniscule amount in the consortium—we estimate that amount at about one or two percent of the total, based primarily on our continuing INMARSAT role. Thus, having contributed approximately 25 percent of the assets of the consortium, Comsat would be entitled to buy only between 1 and 2 percent. What we would receive in return would be some amount of cash, the actual amount depending on the determination by an arbitration panel of what constitutes a fair market value for communications facilities in various stages of depreciation. At the same time, AT&T and the International Record Carriers would be contributing approximately 75 percent of the assets of the consortium and would be entitled to buy something on the order of 98 percent. The

effect of these arrangements is that Comsat's revenue stream from the INTELSAT system would come to an abrupt halt. That revenue stream last year was about \$105 million.

I recognize that only about 60 percent of our current Comsat—COMSAT General operating revenues are derived from INTELSAT, most of the balance being attributable to the MARISAT and COMSTAR Systems. Superficially, therefore, it might appear that Comsat's plight might not be as severe as I describe it. However, the MARISAT System will be phased out in several years, to be replaced by INMAR-SAT in which Comsat's ownership interest is not substantial. Similarly, the COM-STAR System will be replaced in several years by an AT&T follow-on system in which Comsat will not be permitted by current FCC policy to play a role. And, although we look forward to the operation of the Satellite Business System domestic satellites in which we have a partnership interest, our continued participation in that venture remains under the cloud of a Justice Department investigation and judicial review and under the best of circumstances, it will still be quite a few years before this enterprise could be in the black. In sum, our future sources of operating revenues, apart from the INTELSAT system, appear limited and questionable at the moment.

Thus, if S. 611 is enacted, prudent business judgment would dictate an immediate and radical retrenchment by Comsat. We might find it necessary to lease or sell our Laboratories and Headquarters, to eliminate from the payroll a significant number of our present staff of 1,200 highly educated and trained scientists and technicians, and to abandon most of our research and development programs. And, most ironic of all, these steps would have to take place precisely at the time these people and programs would be most crucial to our newly assigned tasks of developing new ventures and marketing new services in order to compete with AT&T and the International Record Carriers. If ever there was a "Catch 22", this is it.

The Comsat that would emerge from the enactment of S. 611 would be more of a shell than a functioning organization, for it would be deprived of most of its best people, its hard won revenues, its future hopes and aspirations and, if I may say so without being thought overly dramatic, its spirit and its pride, for I believe that is the inevitable result when outstanding performance is rewarded with ingratitude.

If this result should come to pass, the adverse impact on Comsat's shareholders and employees would be very severe. More than half of our shareholders are those who purchased our stock in 1963, encouraged by Congress and the Executive to make an equity investment in the future of space technology. It is true that no guarantees were given those investors by the United States Government and that they were well aware that there were significant business risks involved, but I believe the implication was clear that, given success of the business, they would have made an excellent long term investment. That is where we are right now. I cannot believe that any of those investors were aware that one of the risks they were taking was that, once the global satellite system achieved technological and business success, it would be taken away from Comsat by the Government that had set the policy and encouraged their participation in the first instance.

I believe the credibility of Congress is at stake here and that if S. 611 is enacted, this body will never get the American public, with private funds, to underwrite such a venture again. Interestingly enough, two proposals of that nature are before Congress at this time. Senator Schmitt of this Committee and Representative Fuqua, Chairman of the House Science and Technology Committee, have introduced bills to create an Earth Resources Satellite Corporation and a Space Industrialization Corporation, respectively, patterned on the Comsat model. If S. 611 becomes law, financing those ventures with private capital would be difficult indeed.

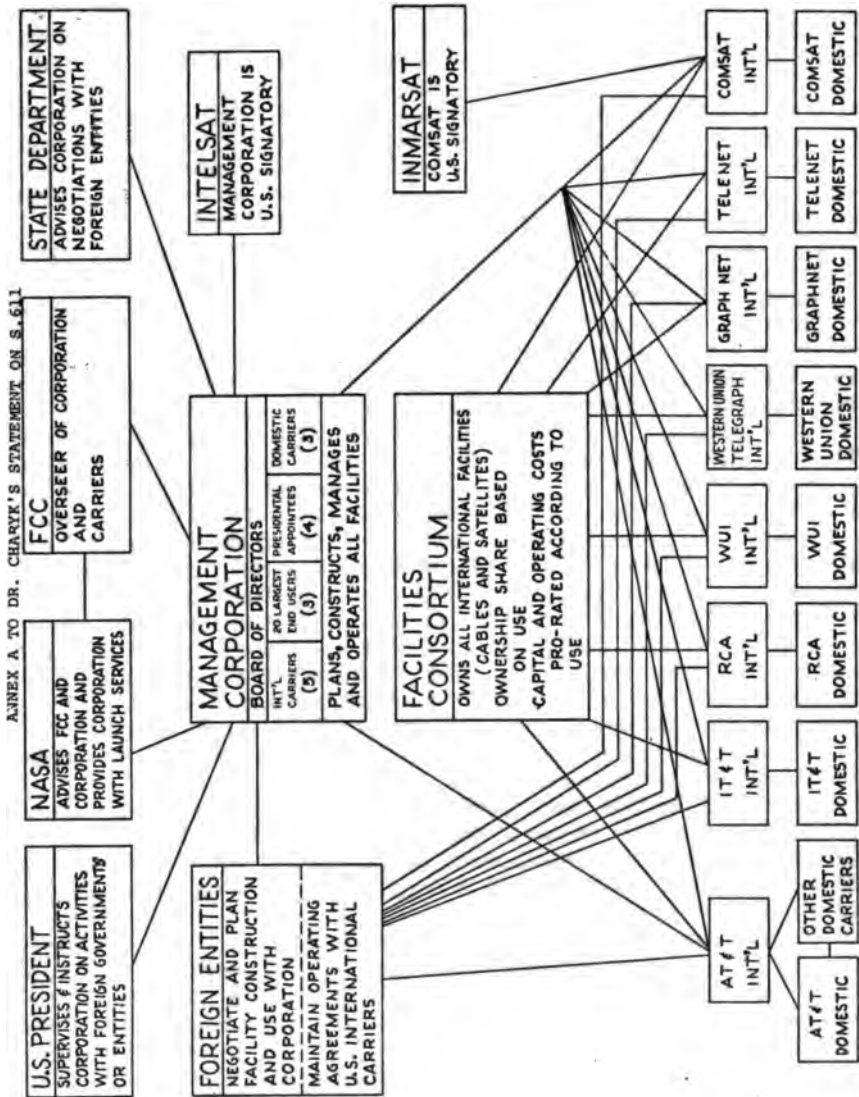
As for Comsat's employees, I cannot imagine a more demoralizing event. Many of them gave up budding careers with other corporations to come to Comsat. Many of them have served Comsat for ten to fifteen years. To displace them now, especially when the impetus for the change results from the success, rather than the failure, of their efforts, seems to me a most unfortunate consequence. And, I would be remiss if I did not remind you that the dispersion of this excellent staff will result in the loss to the United States of a valuable asset—the collective knowledge, experience and teamwork abilities of these people. This resource will be difficult, if not impossible, to duplicate or rebuild.

I would like to make one final point relevant to Comsat before I close. S. 611 repeals the Communications Satellite act of 1962, including Section(b)(3), which limits, by percentage, the number of shares of Comsat stock that can be owned by any one person or by a group of affiliated persons. With the repeal of that protective provision of the Satellite act, adopted by Congress to prevent Comsat from being dominated by any particular interest group, the Corporation, with the substantial amount of cash received from the facilities consortium for its assets and a

predictably lower stock price because of its unpromising prospects, would clearly be a ripe target for a corporate takeover. That would, of course, complete the disappearing act I predict for Comsat if S. 611 is enacted.

Now I would like to turn for a moment to the international telecommunications facilities planning aspects of S. 622, a related bill. The objective of that bill, like S. 611, is to provide the greatest benefits possible to the public in the use of international telecommunications facilities. However, the paths taken by the two bills in seeking to accomplish that objective are markedly different. While S. 611 would provide for a major restructuring of the industry, S. 622 would continue to rely on existing institutional structures and regulatory mechanisms insofar as they continue to serve the public interest. Further while S. 611 would seek to promote competition through means which we think are unworkable, S. 622 would rely on competition only to the extent practical and beneficial in the provision of international telecommunications services. We favor the approach taken by S. 622.

I want to thank the Subcommittee for the opportunity of letting me testify here today. I will be happy to try to answer any questions that the members or the staff of the Subcommittee may have.



Senator HOLLINGS. Thank you, Dr. Charyk.

Mr. HONG. Mr. Chairman, I am director of regulatory agencies of the State of Hawaii. At the request of Governor George R. Ariyoshi, I am presenting the testimony of the State of Hawaii on S. 611 and S. 622.

I wish to thank the subcommittee for the opportunity to participate in the hearings on these important bills, and also my special thanks to Senator Goldwater. And I would like my statement in the record.

Senator HOLLINGS. It will be included in the record.

Mr. HONG. More than 20 years ago, Hawaii was admitted into the United States on an equal footing with the other States. The promise of equal treatment contained in the Statehood Act, however, has not been fulfilled in the field of telecommunications. The charges for a number of telecommunications services between Hawaii and the mainland are higher than rates for comparable services between mainland points.

For example, citizens of Hawaii have been paying higher rates for interstate telephone calls than mainland ratepayers for comparable distances. Users on the mainland are also charged more for calls to Hawaii than calls to other areas in the United States.

In addition, the citizens of Hawaii are denied the full benefits of new and innovative telecommunications services. Certain services offered on the mainland are not available in Hawaii at any price.

Not only has the difference in treatment harmed individual ratepayers, but it also discouraged the full development of interstate communications. This has adversely affected the State, its economy, and the American people. It suggests a separation between the people of Hawaii and the other citizens of the United States.

This discrimination has arisen, in part, from explicit language contained in the Communications Act of 1934.

Section 222 of this act classifies the State of Hawaii as an international point. The other 49 States in the Union, the District of Columbia and even points outside of the United States are afforded domestic status. Only Hawaii is singled out for separate statutory treatment.

Moreover, the existence of this statute has directly and indirectly impeded the implementation of the policy of the FCC to integrate the State into the rate and service structure prevailing in the mainland. The statute has provided those who benefit from the continuation of discrimination with an argument that discriminatory treatment is sanctioned or required by law.

In cases such as the mailgram decision, the courts, in an expansive interpretation of section 222, have used the statute to bar the introduction of certain services into the State. The FCC and the Department of Justice have not sought judicial review of such cases on the grounds that Congress contemplates prompt repeal of section 222.

The repeal of the anomalous classification of Hawaii as an international point contained in section 222 is long overdue. There is no reason to deny the State of Hawaii equal status with the other States in the Union. The FCC and the former Office of Telecommunications Policy, two Federal agencies with great expertise in telecommunications matters, have testified before this subcommittee in

favor of the passage of legislation designed to include Hawaii into the domestic telecommunications system. The Federal courts have also urged Congress to repeal this statute.

Furthermore, this committee has already recognized that legislative reform is necessary. On August 3, 1977, the committee reported favorably on S. 1866, a bill designed to include Hawaii within the domestic telecommunications system. The Senate, recognizing the great need for this measure, passed this legislation on two separate occasions, but the bill was never enacted into law.

One of the purposes of both S. 611 and S. 622 is to make Hawaii, a State of the United States, a domestic service point for the purposes of telecommunications regulation. The State of Hawaii supports this purpose. However, there are problems with both bills. Although these problems may be technical, they do require attention.

S. 622 contains ambiguities with respect to the status of mainland-Hawaii service. Section 202(a)(1) of S. 622 is apparently designed to include service between Hawaii and the other States of the Union as domestic telegraph operations as defined in section 222(a)(5) and to exclude such service from the term "international telegraph operations" in section 222(a)(6). However, under S. 622, both these definitions continue to contain references to "Continental United States". This term is explicitly defined in section 202(a)(3) of the bill as "contiguous States of the Union."

The State is concerned that Hawaii would be excluded from the definition of contiguous States of the Union. Therefore, the state recommends that section 222(a)(10) of the Communications Act be amended to delete the words "except Hawaii." In this way there would be no doubt that Hawaii would be classified in the same manner as the other States in the Union.

Section 223 of S. 611 specifically provides that section 222 of the Communications Act, with its discriminatory classification of Hawaii, will cease to have any effect on the 360th day after the date of enactment. For more than 20 years, the State has waited for the passage of legislation that would afford it equality with other states in the Union. Although the State takes no position on the propriety of delay with respect to the international telecommunications issues surrounding the total repeal of section 222, there is no reason for the deferral of section 223 as it affects the Hawaii-mainland traffic. The subcommittee should alter section 223 to specify that Hawaii need not wait 360 days to be accorded the same rights as the other States in the Union.

There is an additional matter which I would like to discuss today. Section 201(b) of the act presently provides in substance that all charges, practices, classifications and regulations should be just and reasonable. Section 202(a) contains a broad prohibition against the perpetration of any unjust or unreasonable discrimination by a common carrier. This statute specifically prohibits, *inter alia*, a carrier from subjecting a class of persons or locality to any undue or unreasonable prejudice or disadvantage.

These specific statutory provisions are amended by sections 203 and 204 of S. 611. Although section 208(b) of S. 611 contains analogous requirements, the State is of the view that the Subcommittee should assure that the safeguards in section 208(b) provide no less

protection than the differently worded provisions in sections 201 and 202 of the Communications Act.

The State of Hawaii wishes to express its appreciation of the efforts of this subcommittee and the full committee to redress the discrimination against the State. In recent years, the committee has reported favorably on S. Res 318, which called for the prompt implementation of rate and service integration, and S. 1866, which would include Hawaii within the domestic telecommunications network. Both measures were subsequently adopted by the Senate.

The committee report on S. Res 318 outlines the historic discrimination against the State. The report on S. 1866 dramatically underscores the need for legislation which would include Hawaii within the domestic telecommunications network. The State requests that these reports be included in the record on S. 611 and S. 622.

The State wishes to reaffirm its support for legislation that would include Hawaii into the framework of the domestic telecommunications system. In addition, it urges the subcommittee to consider the changes proposed in this testimony.

Thank you for the opportunity to appear here today.

[The statement follows:]

STATEMENT OF HON. TANY S. HONG, DIRECTOR OF THE DEPARTMENT OF
REGULATORY AGENCIES OF THE STATE OF HAWAII

Mr. Chairman: May name is Tany S. Hong, the Director of Regulatory Agencies of the State of Hawaii. At the request of Governor George R. Ariyoshi, I am presenting the testimony of the State of Hawaii on S. 611, the "Communications Act Amendments of 1979" and S. 622, the "Telecommunications Competition and Deregulation Act of 1979". I wish to thank the Subcommittee for the opportunity to participate in the hearings on these important bills.

More than twenty years ago, Hawaii was admitted into the United States on an "equal footing with the other states. . . ."¹ The promise of equal treatment contained in the Statehood act, however, has not been fulfilled in the field of telecommunications. The charges for a number of telecommunications services between Hawaii and the Mainland are higher than rates for comparable services between Mainland points. For example, citizens of Hawaii have been paying higher rates for interstate telephone calls than Mainland ratepayers for comparable distances. Users on the Mainland are also charged more for calls to Hawaii than calls to other areas in the United States.

In addition, the citizens of Hawaii are denied the full benefits of new and innovative telecommunications services. Certain services offered on the Mainland are not available in Hawaii at any price.

Not only has the difference in treatment harmed individual ratepayers, but it also discouraged the full development of interstate communications. This has adversely affected the State, its economy, and the American people. It suggests a separation between the people of Hawaii and the other citizens of the United States.

This discrimination has arisen, in part, from explicit language contained in the Communications Act of 1934. Section 222 of this Act classifies the State of Hawaii as an "international" point. The other forty-nine states in the Union, the District of Columbia and even points outside of the United States are afforded domestic status. Only Hawaii is singled out for separate statutory treatment.

Moreover, the existence of this statute has directly and indirectly impeded the implementation of the policy of the Federal Communications Commission to integrate the State into the rate and service structure prevailing in the Mainland. The statute has provided those who benefit from the continuation of discrimination with an argument that discriminatory treatment is sanctioned or required by law. As the Federal Communications Commission has stated:

The Commission believes that Section 222 and disagreement as its scope has contributed greatly to the delay in securing new services and facilities for Hawaiian

¹ Act of March 18, 1959, Pub. L. No. 86-3 § 1, 73 Stat. 4.

points. . . . [I]ntegration of Hawaii into the domestic Mainland structure has been a long, difficult process due, at least in part to Section 222 complications. . . .

Our experience indicates that the artificial constraints of Section 222 have frustrated the Commission's efforts in dealing with communications proposals and have delayed, and sometimes foreclosed, the availability of low cost and innovative communications services.²

In cases such as the "mailgram" decision³ the courts, in an expansive interpretation of Section 222, have used the statute to bar the introduction of certain services into the State. The F.C.C. and the Department of Justice have not sought judicial review of such cases on the grounds that Congress contemplates prompt repeal of Section 222. In a memorandum before the Supreme Court requesting that the Court not review the "mailgram" decision, the government argued:

On August 5, 1977, the Senate passed S. 1866, 95th Cong., 1st Sess., which would amend Section 222 to include Hawaii in the same category as other states. . . . [T]he Commission believes that the decision of the Court below is erroneous, and would so contend if this Court were to grant certiorari. Both the United States and the Commission are of the view, however, that because the issue is highly likely to be resolved in the 95th Congress, the petition for a writ of certiorari should be denied.⁴

The repeal of the anomalous classification of Hawaii as an "international" point contained in Section 222 is long overdue. There is no reason to deny the State of Hawaii equal status with the other states in the Union. The Federal Communications System and the former Office of Telecommunications Policy,⁵ two federal agencies with great expertise in telecommunications matters, have testified before this Subcommittee in favor of the passage of legislation designed to include Hawaii into the domestic telecommunications system.⁶ The federal courts have also urged Congress to repeal this statute.⁷

Furthermore, this Committee has already recognized that legislative reform is necessary. On August 3, 1977, the Committee reported favorably on S. 1866, a bill designed to include Hawaii within the domestic telecommunications system. In the Report on S. 1866, the Committee asserted that:

Section 222 was enacted in 1943, in the light of special circumstances then prevailing and 16 years before Hawaii was admitted to the Union. it is now 18 years since Hawaii became a state. Experience in these years has shown that the designation of Hawaii as an international point for the purposes of section 222 has frustrated the efforts of the Federal Communications Commission and private industry to afford Hawaii similar treatment as her sister states. This disparity has resulted generally in higher rates for interstate communications to and from Hawaii, and in fewer services and facilities. Exclusion of Hawaii from the definition of "Continental United States" restricts the classes of carriers which are allowed to provide services to Hawaii. S. 1866 seeks to make available to Hawaii the same modern telecommunications facilities, services and rate-making principles which are now or will be enjoyed throughout the Continental United States. The amendment will accomplish this by including Hawaii within the definition of "Continental United States," thereby removing artificial constraints on the availability of telecommunications offerings, the entry of new carriers into the Hawaiian market and service integration into the mainland structure.⁸

The Senate, recognizing the great need for this measure, passed this legislation on two separate occasions⁹ but the bill was never enacted into law.

² Letter from Chief, Common Carrier Bureau, Federal Communications Commission to Chairman, Senate Committee on Commerce, Science and Transportation, July 26, 1977 at 5, reprinted at Repeal of Section 222 of the Communications Act of 1934, Hearings on S. 1162 and S. 1866 Before the Subcomm. on Communications of the Senate Comm. on Commerce, Science and Transportation, 95th Cong. 1st Sess., 102-103 ("Hearings"). See *In the Matter of Integration of Rates and Services*, 65 FCC 2d 325 at n.5 (1977).

³ *Western Union International, Inc. v. Federal Communications Commission*, 544 F.2d 87 (2d Cir. 1976), cert. den. 434 U.S. 903 (1977).

⁴ Memorandum for the Federal Respondents, *Western Union Telegraph Co. v. Western Union International*, October 1977 at 3-4.

⁵ Most of this agency's functions were assumed by the National Telecommunications and Information Administration.

⁶ Hearings, *supra* n.2 at 91-100 (Statement of Walter R. Hinchman) and 106-110 (Statement of William J. Thaler).

⁷ See, e.g., *ITT World Communications Inc. v. FCC*, No. 77-4028 (2d Cir. decided March 22, 1978).

⁸ S. Rep. 95-389, 95th Cong. 1st Sess. 1 (1977).

⁹ The Senate first passed S. 1866 on August 5, 1977, two days after the bill was reported out of Committee. 123 Cong. Rec. S13839-13861. This measure was again passed by the Senate as an amendment to S. 1547 on January 31, 1978. 124 Cong. Rec. S964-968 (1978).

One of the purposes of both S. 611 and S. 622 is to make Hawaii, a state of the United States, a "domestic" service point for the purposes of telecommunications regulation. The State of Hawaii supports this purpose. However, there are problems with both bills. Although these problems may be "technical", they do require attention.

S. 622 contains ambiguities with respect to the status of Mainland-Hawaii service. Section 202(a)(1) of S. 622 is apparently designed to include service between Hawaii and the other states of the Union as "domestic telegraph operations" as defined in Section 222(a)(5) and to exclude such service from the term "international telegraph operations" in Section 222(a)(6). However, under S. 622, both these definitions continue to contain references to "Continental United States". This term is explicitly defined in Section 202(a)(3) of the bill as "*contiguous states of the Union*".¹⁰

The State is concerned that Hawaii would be excluded from the definition of "contiguous states of the Union." Therefore, the State recommends that Section 222(a)(10) of the Communications Act of 1934 be amended to delete the words "except Hawaii". In this way there would be no doubt that Hawaii would be classified in the same manner as the other states in the Union.

Section 223 of S. 611 specifically provides that Section 222 of the Communications Act of 1934, with its discriminatory classification of Hawaii "will cease to have any effect on the 360th day after the date of enactment." For more than twenty years the State has waited for the passage of legislation that would afford it equality with other states in the Union. Although the State takes no position on the propriety of this delay with respect to the international telecommunications issues surrounding the total repeal of Section 222, there is no reason for the deferral of Section 223 as it affects the Hawaii-Mainland traffic. The subcommittee should alter Section 223 to specify that Hawaii need not wait 360 days to be accorded the same rights as the other states in the Union.

There is an additional matter which I would like to discuss today. Section 201(b) of the Communications Act presently provides in substance that all charges, practices, classifications and regulations should be just and reasonable. Section 202(a) contains a broad prohibition against the perpetration of any unjust or unreasonable discrimination by a common carrier. This statute specifically prohibits, *inter alia*, a carrier from subjecting a "class of persons or locality to any undue or unreasonable prejudice or disadvantage".¹¹

These specific statutory provisions are amended by Sections 203 and 204 of S. 611. Although Section 208(b) of S. 611 contains analogous requirements, the State is of the view that the Subcommittee should assure that the safeguards in Section 208(b) provide no less protection than the differently worded provisions in Section 201 and 202 of the Communications Act.

The State of Hawaii wishes to express its appreciation of the efforts of this Subcommittee and the full Committee to redress the discrimination against the State. In recent years, the Committee has reported favorably on S. Res. 318, which called for the prompt implementation of rate and service integration and S. 1866, which would include Hawaii within the domestic telecommunications network. Both measures were subsequently adopted by the Senate. The Committee Report on S. Res. 318 outlines the historic discrimination against the State. The Report on S. 1866 dramatically underscores the need for legislation which would include Hawaii within the domestic telecommunications network. The State requests that these reports be included in the record on S. 611 and S. 622.

¹⁰ S. 622 defines "domestic telegraph operations" to include, *inter alia*, record communications which originate and terminate at points in Hawaii and the Mainland. Section 202(a) of this bill, however, would also amend the definition of "domestic telegraph operations" in Section 222 to: "... include acceptance, transmission or delivery performed within the *continental United States* between points of origin within and points of exit from, and between points of entry into and points of destination within, the *continental United States* with respect to record communications by wire or radio which either originate or terminate outside the continental United States, Alaska, Canada, Saint Pierre-Miquelon, Mexico and Newfoundland, and also includes the transmission within the *continental United States* of messages which both originate and terminate outside but transmit through the *continental United States*. ..." [Emphasis added.] The definition of "international telegraph operations" in Section 222 as amended by S. 622 contains analogous references to "continental United States".

¹¹ In spite of these explicit statutory enactments, however, the record reflects that on a number of occasions, the implementation of rate and service integration for Hawaii has been prevented or delayed. In the Report on S. Res. 318, a resolution in which the Senate urged the Commission to promptly implement rate integration, this Committee asserted that: "The FCC's failure to insist upon timely compliance with its [rate integration] policy by the carriers and the carriers lack of cooperation, clearly account for the delay in this critical area. S. Rep. No. 94-533, 94th Cong., 1st Sess. 11 (1975)."

The State wishes to reaffirm its support for legislation that would include Hawaii into the framework of the domestic telecommunications system. In addition, it urges the Subcommittee to consider the changes proposed in this testimony.

Thank you for the opportunity to appear here today.

Senator HOLLINGS. Thank you, Mr. Hong.

I have some questions here that Senator Inouye wanted to ask.

What is the status of the NTS rate integration for Hawaii?

Mr. HONG. As you know, the Commission ordered the parties to meet to provide for joint separations, to work on a separations plan. The Commission has appointed a number of people to a Federal-State separations committee, and pleadings were filed in April of this year. It is my understanding that those changes will be made shortly. We hope there will be no undue delay.

Senator HOLLINGS. Has the State been able to relax its effort to secure telecommunications services and nondiscriminatory rates?

Mr. HONG. As far as I know, we have not, and the reason for it, of course, is a long history of discrimination. We have had to file a number of pleadings to prod the parties as well as the agencies involved, for the purposes of resolving this problem that we all face.

I think there is a long history that arose out of the section 252, Mr. Chairman.

Senator HOLLINGS. Section 252 of S. 611 requires a full separation between a provider of domestic and international services, and also between the provider of noncompetitive international public message telephone service or the provider of other international services.

It is Senator Inouye's provision that deals with section 252 that would require the Hawaiian telephone to be a totally separate activities to handle these activities in Hawaii. Would this subsidiary requirement adversely affect the users of services in Hawaii?

Mr. HONG. If they are referring to the Hawaiian telephone company being split up into a number of subsidiaries, this may be difficult, in view of the fact that the company is small in comparison with the other companies that are involved in telecommunications. I am sure it would increase the cost as far as operation is concerned. From that standpoint, it would impact on the citizens of the State of Hawaii.

Senator HOLLINGS. Dr. Charyk, you referred to intermodal competition of satellite versus cable. Mr. Ferris stated there is no real competition; and if anything, competition would lead to overbuilding and higher prices, not lower.

Do you want to comment on that?

Mr. CHARYK. Yes. Let me give you a practical example of where I think intermodal competition has been very effective. Some years ago the carriers, having reached agreement with their European correspondents, proposed to build a so-called SF cable, a cable of some 800 circuit capacity.

The application was filed with the Commission and strong representation was made through the foreign office channels that approval of such a cable should be forthcoming. Comsat argued that such an investment would not be an economical one because the U.S. consumer would be stuck with the consequences of such an investment over the next 25 years, since the theory here is that such a cable is depreciated over 25 years.

We contended that that type of a cable was reaching the point of technical obsolescence and it would be a mistake to saddle the U.S. consumer with the requirement to pay hundreds of millions of dollars over the next 25 years to have the "luxury" of such an inefficient cable. Fortunately, we prevailed in that kind of an argument before the Commission and argued, frankly, that a cable more reflective of modern technology should be developed. At that time it was contended this was very much in the future. However, with the rejection of the SF cable, a new SG cable of some 4,000 circuit capacity was developed in a short time and came into use a few years after the SF cable would have come into being. The net effect is that the U.S. consumer was saved hundreds of millions of dollars in rates over the next 25 years.

That is just one example, and there are others.

Senator HOLLINGS. Other than the one rate case I referred to earlier, where else have you lowered rates?

Mr. CHARYK. We started out with rates of \$4,200 a month, and today the new rates that are going into effect are \$1,340 a month. This is less than one-third of the original number. Now, in the relatively short period of less than 15 years, to have a series of rate reductions so that the rates today are less than one-third of what they were a decade ago I think is a remarkable accomplishment. I think it is suggestive that the technology is being put to work, and with the consumers getting the benefits of this through the rate reductions that will be passed on, hopefully, by the carriers, to the public.

Senator HOLLINGS. Under S. 611, Dr. Charyk, Comsat would be completely free to compete in the domestic and international markets. Yet you take a bleak view of Comsat's ability to do that, because of the established carriers' positions of 10 years ago.

Competitors much smaller than yourselves are successfully challenging that. Why, with all of the expertise and leadership of Comsat, why would they have difficulty?

Mr. CHARYK. I note in my statement, Mr. Chairman, why the international picture is radically different from the domestic. In the international, you have a single entity or monopoly on the other end who is very comfortable in working with the existing carriers, and who is not motivated to invest in additional facilities and to undertake additional operating costs just because a multiplicity of U.S. entrants may desire interconnection with him. So that you have a fundamental constraint in making such arrangements.

Furthermore, competition is practical in only a very small percentage of the total market. As I indicated, about 80 percent of all the circuits are for voice, involving A.T. & T. I don't believe that any practical competition is possible. There is also no practical competition, possible, I don't think, in the telex services, which I believe are financially very profitable.

So you are left with a very small segment of the total market in which you could compete. I suppose it is possible we could make an entry into that area, but it would be for a very small percentage of the total business. At the same time, under this legislation, we would be forsaking or giving up revenues from our present international services which amounted, in the last year, to something

like \$105 million. It would be many, many years, if ever, if we could get up to that level of revenues in any sort of direct competition, even under the most favorable circumstances.

We have, incidentally, tried in a few areas to provide different kinds of service, and we have sought such authority from the FCC. It has been granted by the FCC. We have not been able to make arrangements with the foreign correspondents.

The record carriers have gone out and made arrangements with these correspondents, and ultimately provided a similar type of service, after several years of delay and debate. So it is not an easy course. Even if we were eminently successful, it would be for a very small percentage of the total business and completely out of balance with our present situation, which, as I said, provides revenues of over \$100 million a year.

Senator HOLLINGS. The final customers are connecting domestic carriers or other international carriers. Will they sit on Comsat's board?

Mr. CHARYK. The original Comsat Act provided for the Comsat board to consist of six directors from the carriers, six from the general public, and three appointed by the President. For a variety of reasons, most of the international carriers, certainly all of the large ones, have sold their stock in Comsat at substantial profits. If this bill is enacted, the people who will take the rap will be the small investors, and most of them are very small investors, who have invested for their children, for their education and so on. They have held on faithfully to their shares since 1964, in the promise that this might some day be a successful operation.

But I think the last thing they expected was that if the thing became successful, that the Congress, which had encouraged their participation, would essentially destroy their investment, which the effect of S. 611 would be to do.

Senator HOLLINGS. Mr. Murphy, you indicated that Western Union would be held back for at least 5 years from being allowed into the international telecommunications immediately upon repeal of section 222, because there are substantial and unearned headstarts on the ability to utilize domestic networks. You said it would take considerably longer for the IRC's to establish themselves in the hinterlands than it would for Western Union to make the requisite operating arrangements to enter the overseas market.

What makes you think it would be any easier for Western Union to break into this closed society?

Mr. MURPHY. Mr. Chairman, first, I really don't think it is a closed society. The impression, I think, has been left by some prior testimony that the correspondents will only deal with one particular carrier. This is not so. The fact is, of course, that our overseas correspondents in many cases are governmental entities. But they do have agreements in the international record part of the market, as distinguished from the telephone part of the market, with a number of U.S. carriers, four or more, in some major markets. So there is very active and keen competition.

We do not have a question here where service is not being provided as a result of this. I think we should bear in mind that, as governmental entities, the correspondents must look at the situation and determine for themselves what they think is reasonable

for their particular country. This is a decision which is properly, we would think, a matter of determination for the individual countries.

I would also point out that just in very recent years a new carrier, which had been a regional carrier, has entered the international market. TRT has moved very effectively into the European market and has achieved agreements with the CEPT correspondents. It is possible to do this and it is being done.

As far as Western Union itself is concerned, I think, sir, the point I was trying to make is that we would have to establish a network domestically. We do not have that at the present time. We are limited to operations in five cities on the mainland of the United States. Western Union, of course, operates throughout the mainland. They have 125,000 customer access lines, as compared to our 7,000 lines. It would take us a period of time to put ourselves in a position where we could effectively compete.

As I indicated in my written testimony, we believe there should be a moratorium on Western Union entry of either 5 years or until such time as there is effective competition in the domestic Telex service. I think we should recognize here that there was a quid pro quo involved in Western Union obtaining this domestic monopoly. It is a bit ironic now, after it has benefited over these many years, for Western Union to come in and be riding the white horse of competition.

They have benefited from this, and all we are asking is that we be given a reasonable time so we can put ourselves on an equal footing with them, and then we are quite willing and ready to compete with them, and I think that we will do a very effective job of that.

Senator HOLLINGS. Mr. Hostetler, do you believe there is competition among the IRC's?

Mr. HOSTETLER. Mr. Ferris used the term "apparent competition." I guess that is the term I would use. I believe that one should define competition in terms of whether the user has a meaningful choice, a meaningful choice in terms of price, kind of service that is available, the kind of facilities that are available. And I don't believe that is the situation in the international market today.

All of the carriers charge the same price and provide precisely the same services, and there has been very little that I can see in the way of service enhancement. There has been some, but few new services are being provided.

Senator HOLLINGS. How difficult is it to get operating agreements?

Mr. HOSTETLER. I don't think that problem should be minimized. We haven't been involved in that in recent years, and I expect if we are allowed to go overseas we are going to have some difficulty in negotiating operating agreements. I think for that reason that at least for some interim period the Commission ought to be in a position to insure that those carriers that do have operating agreements are interconnecting with the domestic carriers, so that they can provide services overseas.

I think in the long run, that if Congress sends a signal to the foreign governments by opting for a policy which says that interna-

tional service is going to be part of a single integrated domestic marketplace, and if carriers like Western Union, who do have substantial business bases in the United States, are permitted to go directly overseas, that over a period of time we will be able to break those barriers down. And we are willing to take our chance on that.

Senator HOLLINGS. Do you find that the FCC has leverage to help obtain those agreements?

Mr. HOSTETLER. I don't know that they do. I am not sure that what is proposed in S. 611 really is going to change that. As somebody suggested, it takes two to tango. I think the FCC can play a role. It can urge. It possibly has some leverage.

But in the final analysis, I think the foreign governments are going to have to be persuaded that there are carriers who are ready, willing, and able to serve the marketplace, who are providing new services, and who can bring something to the table that will benefit the foreign users as well.

Senator HOLLINGS. Does anyone else wish to comment on that? Mr. Murphy?

Mr. MURPHY. May I comment, sir?

Senator HOLLINGS. Yes.

Mr. MURPHY. It was Mr. Hostetler's statement that there was only some semblance of competition in the international area. He notes that the rates are generally the same and he is not aware of any technological advances or service improvements.

I think the record will show that there is a solid history of technological advances and service improvements. As a matter of fact, the Telex service was first introduced and pioneered by RCA Globcom. It was not until 10 years later that Western Union offered it domestically, and then we saw a history of rate increases in the domestic Telex service, as compared to rate decreases in the international Telex service.

Indeed, in the last year and a half, we are now absorbing rate increases from Western Union at an annual rate of \$2.2 million. These are costs which we, RCA Globcom, are absorbing. These costs are not being passed on to the general public.

Western Union now is trying to get higher rates in these services before the Commission. If there are questions on returns, the subcommittee might want to consider looking at the Western Union rates of return on Telex service.

As far as new services, we have introduced data services recently—just about a year ago, we introduced a high speed facsimile service with Japan. We have extended this to 10 countries.

On the matter of rates, in many cases, the rates are the same. But this is because of the competitive situation. As I indicated to you a bit earlier, at the time when the rates were reduced as a result of the Comsat rate reductions to the carriers, the carriers cut their own rates in varying amounts.

And if those rates were not matched, we would have lost business.

Indeed, there is no question that there is effective competition. Our rates are lower than 10 years ago. This is despite inflation, despite raising costs of labor and material, despite the fact that we are paying, just in the last 18 months, over \$2 million more to

Western Union, and indeed, \$1.8 million more in the case of RCA on an annual basis to A.T. & T.

Thank you.

Mr. HOSTETLER. Could I add two facts?

Senator HOLLINGS. Yes, sir.

Mr. HOSTETLER. There has been some question about the international record carrier rate of return. The FCC has been doing some auditing. According to data that ITT filed with the Commission, the ITT rate of return on its investment, International Telex, was in the range of 56 percent a year ago.

I can assure you that Western Union is not in that ballpark.

Second, in comparing domestic and international carrier rates for telex service to Mexico, which we are able to provide directly on a country-to-country basis, the domestic rate is 75 cents per minute for telex service. The international carriers are charging \$1.33 per minute for the same service.

They are charging their customers who have international carrier-provided telex machines and accordingly, don't have access to competitive services.

Senator HOLLINGS. Very good.

Dr. Charyk, or does anyone else wish to comment further?

[No response.]

Senator HOLLINGS. They are getting together on their rate of return.

Mr. MURPHY. I would just like to make one final comment. Mr. Hostetler has conveniently neglected in his statement to include the cost of the terminal, which in the case of the service offered by RCA Globcom, is included in that rate.

In the case of Western Union, the customer has to pay for that terminal and that may be on the order of anywhere from \$75 up, depending on the terminal for the service.

It is not really tarified on a comparable basis.

Dr. CHARYK. I don't want to get into rate-of-return discussions because I am not really sufficiently familiar with what their rate of return might be. I think it is significant that the last investigation on that was in 1958, which is 22 years ago.

We have recently cut our rates by 15 percent. It is going to be interesting to see how this is flowed through to the customers. This is something, obviously, that the FCC will have to address.

It is my understanding that some of the escrow funds established from the previous rate reduction are in escrow because of the disagreement between the record carriers and the FCC as to details of such a flowthrough.

Senator HOLLINGS. Do you think the introduction of our bill did cause Comsat stock to go up three points?

Dr. CHARYK. If S. 611 is enacted, it might pass out of sight in the other direction, Mr. Chairman.

Senator HOLLINGS. And by the way, your presidential appointees, I think there was discussion on the previous panel; and there are three part-time presidential appointees.

Do you have any comment on how well they work?

Dr. CHARYK. I am happy to address that, Mr. Chairman, because I think in the history of Comsat, we have been extremely fortunate in the Presidential appointments that have been made. The direc-

tors have been most effective. They have been hard-working, conscientious, and I think they have made substantive contributions to the development of the corporation.

Senator HOLLINGS. We appreciate the appearance of each of you. Thank you very much.

The committee will be in recess until 2 p.m.

[Whereupon, at 12:30 p.m., the hearing recessed, to reconvene at 2 p.m. of the same day.]

AFTERNOON SESSION

Senator SCHMITT [presiding]. The hearing will come to order.

This afternoon, the subcommittee will continue its examination of the international common carrier issues contained in the proposed amendments to the Communications Act of 1934.

We have with us, I believe in the order that they are seated from left to right: Mr. George Knapp, International Telephone & Telegraph Corp.; Mr. Donald Kuyper, General Telephone & Electronics Corp.; and Mr. Stanford Weinstein of Graphnet, Inc.

Mr. Knapp, if you would like to begin with your testimony. If you or any of the witnesses want to summarize, you may do so.

We are going to give you 10 minutes for your presentation. But the entire statement will be included in the record.

STATEMENT OF GEORGE F. KNAPP, VICE PRESIDENT, INTERNATIONAL TELEPHONE & TELEGRAPH CORP.

Mr. KNAPP. Thank you.

Today I represent ITT World Communications, a leading international record carrier that provides telex, message, facsimile, data and private line services to 137 foreign countries in competition with several other U.S. carriers.

The subcommittee's primary objective of maximizing competition for international services, given the constraint that the United States does not have control over both ends of those services, is one we support.

But we are concerned that the superstructure contemplated by S. 611 creates a number of rather serious problems, which stem from the unique nature of the international communications structure.

We think those problems could be largely eliminated by a less formal approach to the attainment of the subcommittee's objective.

The International Facilities Management Corporation, IFMC, contemplated by S. 611, lies at the heart of most of the problems which we foresee. S. 611 would assign to the IFMC authority for the planning, construction, and operation of all international telecommunications facilities, and would thereby largely exclude the investors, or beneficial owners of those facilities, from the decision-making process.

In the first place, the international carriers would be permitted to select only 5 of the 15 members of the IFMC's board of directors, and A.T. & T. can be expected to name three of those five.

Under the IFMC concept, the international carriers would be required to finance any new facilities which the IFMC determined to construct, but would have no meaningful voice in a decision to go forward with such new facilities.

I also note that the IFMC is authorized by S. 611 to advise and assist domestic telecommunications carriers in the establishment of operating agreements with overseas telecommunications entities. We are not entirely sure what is intended by this authorization, but there is at least an implication that the IFMC would use its power to withhold agreement on new international facilities, which various overseas administrations may desire, in order to coerce those administrations into providing operating agreements for one or more U.S. domestic carriers.

In addition, since the IFMC would be authorized to negotiate with foreign administrations on behalf of some U.S. entities, while other U.S. carriers would represent themselves, an inherently unbalanced arrangement is created. In particular, the objectivity of the IFMC would seem likely to be distorted with respect to its actions in the management of, or planning for facilities of parties not so represented.

And, by combining negotiation with the planning function, the IFMC might be placed in a position where it may be required to take a position at odds with optimal planning, for purposes of pressuring one of more overseas administrations into granting operating agreements to U.S. domestic carriers.

Turning to a different but equally serious problem, S. 611 appears to contemplate that the international carriers will not provide service directly to end-users. As S. 611 recognizes, the U.S. international carriers are the correspondents of the overseas telecommunications administrations and, as such, are uniquely able to encourage those overseas administrations toward expanded and improved service offerings which those monopoly overseas administrations may have no incentive to provide.

If the U.S. international carriers are effectively removed from a participatory role in the establishment of services to be provided to end-users in the United States, those carriers are likely to have little or no motivation for pressing their overseas correspondents for the initiation of particular services, or service improvements.

Also, a basically arbitrary inbound allocation formula contemplated by S. 611 essentially eliminates any competitive flexibility.

The net result is that the international carrier is largely deprived of any competitive incentive to press its overseas correspondent for initiation of new services or service improvements.

Having reviewed these problems, we suggest that a regulatory superstructure is not required to address the subcommittee's concerns here. On balance, we think the existing regulatory framework for international telecommunications services has worked.

In international data/record communications services, a spirited competition has prevailed among the IRC's. This competition has resulted in continuous service improvements for the users of services provided by those carriers, as well as a general decline in rates, even in the face of the sharp inflation experienced over the last decade.

There are only two major deficiencies in the present regulation of international telecommunications services. First there is no effective mechanism for resolving a continuing controversy among the international facility owners over the desirability of cable or satellite facilities. Contributing to this problem is a perceived lack

of neutrality on the part of the FCC in this area, and its apparent desire to dominate planning activities. Thus, the Commission cannot effectively serve as an arbiter of these competing interests.

Second, there is a need for specific congressional guidance with respect to a threat to the continuing viability of the present competitive international data/record carriers from potential entry into that market by monopoly-based carriers.

Therefore, ITT recommends that the ownership, management, and construction of international facilities should remain with the individual common carriers providing services via those facilities, and that a new International Facilities Planning Committee be formed, comprised of representatives of each international telecommunications carrier and the National Telecommunications and Information Agency. Representatives of the Department of State, Department of Defense, and the FCC should be invited to participate as observers. To assure neutrality, the committee should be chaired by the representative of NTIA. I should note here that the committee which we are proposing is similar to the facilities planning task force contemplated by H.R. 3333.

The Committee would have overall charge of the international facilities planning process, subject, of course, to recommendations and other substantive input from the participating international carriers.

The Committee would also represent U.S. interests in any facility negotiations or discussions with foreign governments or their telecommunications entities. And, as contemplated by section 247(a) of S. 611, the President should exercise supervision over, and issue appropriate instructions to the Committee.

Since international record carriers are subject to effective competition, that competition obviates the need for rate or facility regulation.

The other serious regulatory deficiency for the international data/record carriers is the threat to the competitive viability of those carriers created by the potential entry of the monopoly-based carriers, A.T. & T., Comsat, and Western Union, into unrestricted competition with the present IRC's.

Where one or more monopoly-based carriers is permitted unrestricted entry into that competitive environment, equivalent competitive opportunities among the various competitors simply do not exist. Monopoly-based carriers, controlling either a substantial portion of the traffic stream through their monopoly operations or controlling the facilities which competitors must use for their overseas services, are in a position to favor their own operations, and can be expected to do so.

Section 252(b) appears to rule out any overseas data/record service on the part of A.T. & T. so long as that carrier continues its monopoly or near-monopoly control over overseas telephone service. We heartily support this proposal.

With respect to Comsat, we believe that the best solution is to leave that carrier in its present role as a carriers' carrier, supplying satellite facilities to international carriers which operate at the "retail" level. However, if you wish to permit Comsat to participate in "retail" international services, we strongly urge you to require Comsat to establish a fully separate entity for the provision of any

such retail international services. That new Comsat entity, as well as all of its competitors, should then receive access to Comsat's satellite facilities on either an IRU basis or a cost-sharing basis. Of course, operating relationships between Comsat and its new retail entity must be on an arms-length basis, and on terms identical to those which Comsat makes available to competing, non-affiliated international carriers. While some abuses between Comsat and such a new retail affiliate may be simply unavoidable, ITT believes that a competitive environment for international data/record services which include such a Comsat entity would at least be manageable.

I also urge you not to ignore the serious competitive threat to the present IRC's, if Western Union were authorized to extend its domestic work to overseas points.

Western Union's Telex/TWX network serves approximately 125,000 teleprinters in the United States. By comparison, the six competing IRC's, in the aggregate, have only approximately 10 percent of that number of subscribers.

In addition, those IRC's are presently confined to operations in five gateway cities. Given Western Union's present monopoly control of, by far, the major proportion of U.S. data/record users, the IRC's must be given some reasonable period of time to develop their own broadband domestic subscriber networks in order to be viably competitive against a Western Union authorized to provide international data/record services.

I would recommend that a moratorium period of 5 years be included in the bill.

To sum up ITT's position, Mr. Chairman, it is our view that the existing statutory framework has, by and large, led to a remarkably viable and effective competitive environment for international data/record services.

We urge that this environment be maintained with only a minimum of statutory changes designed to address longstanding, specific problems which appear at this point not to lend themselves to a solution under the present regulatory structure.

Those changes, in our view, would entail:

First, the creation of an International Facilities Planning Committee, to perform the planning function for future international facilities;

Second, deregulation of the process of adding new international facilities; and

Third, the introduction of meaningful restrictions on the participation by monopoly-based carriers in the provision of competitive international data/record services.

These three points summarize our position with respect to the international aspects of the bills.

I appreciate the opportunity to submit my testimony for the record.

Thank you very much.

Senator HOLLINGS [presiding]. Thank you very much. Your full statement will be included.

[The statement follows:]

STATEMENT OF GEORGE F. KNAPP, VICE PRESIDENT OF INTERNATIONAL TELEPHONE & TELEGRAPH CORP.

Mr. Chairman, we appreciate the opportunity to again participate in your hearings being held by this Subcommittee on S. 611 and S. 622.

INTRODUCTION

I am George F. Knapp, Vice President of International Telephone and Telegraph Corporation (ITT) and Group Executive of ITT's Communications Operations Group.

Today I represent ITT World Communications, Inc., a leading international record carrier that provides telex, message, facsimile, data and private line services to 137 foreign countries in competition with several other carriers.

INTERNATIONAL COMMUNICATIONS CONSIDERATIONS

I have testified before you earlier with respect to domestic communications considerations reflected in S. 611 and S. 622, and will focus today on the international communications aspects of those bills. Let me begin by expressing our understanding that the Subcommittee's primary objective is to maximize competition for international services, given the constraint that the United States does not have control over the entirety of those services. We support that objective. We are, however, concerned that the superstructure contemplated by S. 611 creates a number of rather serious problems, which stem from the unique nature of the international communications structure. Those problems, which I will address subsequently, could be largely eliminated by a less structured approach to achieving that objective than is proposed by S. 611.

The International Facilities Management Corporation contemplated by S. 611 (which I will hereafter refer to as the IFMC) lies at the heart of most of the problems which we foresee. S. 611 would assign to the IFMC authority for the planning, construction and operation of all international telecommunications facilities, and would thereby largely exclude the investors, or beneficial owners of those facilities, from the decisional process with respect to such facilities.

The international carriers would be permitted to select only five of the 15 members of the IFMC's Board of Directors, and AT&T can be expected to name three of those five. Thus, under that IFMC Concept, the international carriers would be required to finance any new facilities which the IFMC determined to construct, but would have no meaningful voice in a decision to go forward with such new facilities. This may raise the Constitutional question of whether there would be a taking of property without just compensation.

In addition, the three IFMC Board Members allocated to the 20 largest end-users can be expected to establish a substantial bias in favor of the interests of those large end-users. I think it almost goes without saying that the interests of those large users are in many cases substantially different from the interests of the multiplicity of smaller users of international telecommunications services.

Similarly, the four IFMC directors which would be appointed by the President suggest a problem which we have experienced in connection with COMSAT. A Congressionally created communications entity, with Presidentially appointed directors, appears to suggest to foreign governments, and their telecommunications administrations, that the entity is under the aegis of the U.S. governments, or, at the least, that this government sanctions the acts of such an entity. We do not see a sufficiently strong public interest in maintaining Presidentially appointed directors, for an entity such as the IFMC, to offset the potential misunderstandings with other governments which may result from that appointment.

We also note that the IFMC is authorized by S. 611 to "advise and assist" domestic telecommunications carriers in the establishment of operating agreements with overseas telecommunications entities. We are not entirely sure what is intended by this authorization, but there is at least an implication that the IFMC would use its power to withhold agreement on new international facilities, which various overseas administrations may desire, in order to coerce those administrations into providing operating agreements for one or more U.S. domestic carriers. This presumed tactic is somewhat similar to the tack which the FCC has been following in connection with its authorization of a new TAT-7 cable facility. Based on ITT Worldcom's relationships with various overseas administrations, I can say with some authority that such tactics only serve to alienate those overseas administrations and their governments. As a result, such tactics can be expected to redound to the overall detriment of the United States, both with respect to telecommunications services and to relationships between the respective sovereigns.

The situation would be further complicated by the fact that the IFMC would be authorized to negotiate with foreign administrations on behalf of some U.S. entities, while other U.S. carriers would represent themselves, creating an inherently unbal-

anced arrangement. In particular the objectivity of the IFMC would seem likely to be distorted with respect to its actions in the management of, or planning for facilities of parties not so "represented". And, by combining negotiation with the planning function, the IFMC may be placed in a position where it would be unable to optimize that planning function. Instead, it may be required to take a position at odds with such optimal planning for purposes of pressuring one of more overseas administrations into granting operating agreements to U.S. domestic carriers.

Turning to a different but equally serious problem, S. 611 appears to contemplate that the international carriers will not provide service directly to end-users. As we understand S. 611, international carriers will be restricted to providing services through interconnection arrangements with domestic carriers. If it is indeed intended that the international carriers will only offer facilities or services to the domestic carriers, without having any participation in the nature of the services provided or revenues derived therefrom, a serious disincentive to international service improvement will have been created. As S. 611 recognizes, the U.S. international carriers are the correspondents of the overseas telecommunications administrations and, as such, are uniquely able to encourage those overseas administrations toward expanded and improved service offerings which those monopoly overseas administrations may have no incentive to provide. However, if the U.S. international carriers are effectively removed from a participatory role in the establishment of services to be provided to end users in the United States, those carriers are likely to have little or no motivation for pressing their overseas correspondents for the initiation of particular services, or service improvements.

S. 611 apparently tries to deal with this problem by permitting the international carriers to interconnect with domestic affiliates which would be permitted to participate fully in the retail international communications market. Although this approach appears on its face to have some merit, the establishment of a basically arbitrary inbound allocation formula (Section 251 of S. 611) essentially eliminates any competitive flexibility for such an interconnected international/domestic affiliate combination. The net result is that the international carrier is largely deprived of any competitive incentive to press its overseas correspondent for initiation of new services or service improvements.

I would also note that aside from its arbitrary nature, there are also several structural problems with the proposed inbound allocation formula. Since the international carriers, under S. 611, will apparently only be providing a facility, or "pipe", through which various types of traffic will be flowing, it would be virtually impossible for that international carrier to determine, at each moment in time, what type of traffic is flowing through the "pipe" and then allocate each such piece of traffic to the various domestic carriers in accordance with the "formula". Moreover, I would note that, realistically, such a formula can only be appropriately applied to international message traffic, since telex and other switched international services are routed by the overseas sender either to a specific domestic carrier or to specific terminal devices, which for the most part are associated with the system of a particular "retail" carrier.

Having described, Mr. Chairman, the problems which we perceive in the regulatory superstructure contemplated by S. 611 for international services, I would ask the Subcommittee to consider our position that such a regulatory superstructure is not required to address the Subcommittee's concerns here. On balance, I think you would have to agree that the existing regulatory framework for international telecommunications services has worked. In international data/record communications services a spirited competition has prevailed among the IRCs. This competition has resulted in continuous service improvements for the users of the services provided by those carriers, as well as a general decline in rates, even in the face of the sharp inflation experienced over the course of the last decade. I will hereafter suggest a few modifications to the existing regulatory framework for international telecommunications services, which we believe will accomplish the same goals as the major restructuring contemplated by S. 611, and with substantially less cost and dislocation.

There are only two major deficiencies in the present regulation of international telecommunications services which, in our view, suggest a change in the basic regulatory framework. One, there is no effective mechanism for resolving a continuing controversy among the international facility owners over the desirability of cable or satellite facilities for the provision of future international communications services. That controversy is at this point severely handicapping the overall international facilities planning process. Secondly, there is a need for specific Congressional guidance with respect to a threat to the continuing viability of the present competitive international data/record carriers from potential entry into that market by monopoly-based carriers. Each of these deficiencies can be readily addressed by

relatively simple changes from the present, and quite successful, regulatory framework.

The problem today with the international facilities planning process is a lack of coordination between competing cable and satellite interests. At the heart of this problem is the indisputable fact that the international record carriers have a backlog of potential customers seeking international communications channels via cable, and Comsat has an excess of satellite channels available. Consequently, Comsat opposes, almost reflexively, the construction of any new cable facilities.

Contributing to this problem is an apparent bias on the part of the FCC toward new satellite facilities and against new cable facilities. Because of the perceived lack of neutrality on the part of the FCC in this area, and its apparent desire to dominate planning activities, the Commission cannot effectively serve as an arbiter of these competing interests.

Given these circumstances, there is no question that a separate planning body for international facilities is warranted to moderate those competing interests, and to place international facilities planning on a sound, balanced course. However, such a planning body can, and we think should, be far less formal than the highly-structured IFMC contemplated by S. 611.

To this end, ITT recommends that the ownership, management, and construction of international facilities should remain with the individual common carriers providing services via those facilities, and that a new International Facilities Planning Committee be formed, comprised of representatives of each international telecommunications carrier and the National Telecommunications and Information Agency, with representatives of the Department of State, Department of Defense and the FCC invited to participate as observers. To assure neutrality, the Committee should be chaired by the representative of NTIA. I should note here that the Committee which we are proposing is similar to the facilities planning Task Force contemplated by H.R. 3333.

The Committee would have overall charge of the international facilities planning process, subject, of course, to recommendations and other substantive input from the participating international carriers. It would be required to establish, and periodically update, recommend international facility plans for implementation by the international carriers. The planning cycle should include at least the succeeding five-year time frame.

The Committee would also represent U.S. interests in any facility negotiations or discussions with foreign governments or their telecommunications entities. And, as contemplated by Section 247(a) of S. 611, the President should exercise supervision over, and issue appropriate instructions to the Committee, in connection with relationships with foreign governments or entities. This will assure that such relationships are consistent with the national interest and foreign policies of the United States.

Since international record carriers are subject to effective competition, that competition obviates the need for rate or facility regulation for those carriers.

The other serious regulatory deficiency for the international data/record carriers is the threat to the competitive viability of those carriers created by the potential entry of the monopoly-based carriers into unrestricted competition with the present IRCs.

ITT welcomes the opportunity to participate in a competitive environment, where the structure for such competition is basically fair to all participants. However, where one or more monopoly-based carriers is permitted unrestricted entry into that competitive environment, opportunities for true competition are impossible. Those monopoly-based carriers, controlling either a substantial portion of the traffic stream through their monopoly operations or controlling the facilities which competitors must use for their overseas services, are simply in a position to favor their own operations, and can be expected to do so.

The monopoly-based carriers with which we are here concerned are AT&T, with its monopoly control over the entire domestic telephone network as a feed for potential international services, both telephone and data/record; COMSAT, with its control and ownership over all international satellite facilities, a medium which carries approximately 50 percent of all overseas traffic; and Western Union, with its virtual monopoly control over the entire domestic telex, TWX and telegraph message network, a network which presently feeds a substantial portion of the traffic to the IRCs for overseas transmission. The present IRCs would be so seriously disadvantaged in their efforts to compete with such entities that we could anticipate elimination of that competition.

We are very pleased therefore to see that S. 611 has affirmatively addressed one of those monopoly-based carrier problems. Section 252(b) appears to rule out any

overseas data/record service on the part of AT&T so long as that carrier continues its monopoly or near monopoly control over overseas telephone service.

With respect to COMSAT, we believe that the best solution is to leave that carrier in its present role as a carriers' carrier, supplying satellite facilities to international carriers which operate at the "retail" level. In the event, however, that you determine to permit COMSAT to participate in "retail" international services, we strongly urge you to require COMSAT to establish a fully separate entity for the provision of any such "retail" international services.

That new COMSAT entity, as well as all of its competitors should then receive access to COMSAT's satellite facilities on either an IRU basis or a cost-sharing basis. Of course, operating relationships between COMSAT and its new "retail" entity must be on an arms-length basis, and on terms identical to those which COMSAT makes available to competing, non-affiliated international carriers. While some abuses between COMSAT and such a new "retail" affiliate may be simply unavoidable, ITT believes that a competitive environment for international data/record services which includes such a COMSAT entity will at least be manageable.

The remaining monopoly-based potential entrant into the international data/record communications market, Western Union, may appear to be a less formidable competitive threat to the present IRCs because of that carrier's historic unwillingness, or perhaps even inability, to respond to changing communications requirements and opportunities. I urge you, however, not to ignore the serious competitive threat to the present IRCs, should Western Union be authorized to extend its domestic network to overseas points. Western Union's telex/TWX network serves approximately 125 thousand teleprinters in the United States. By comparison, the six competing IRCs, in the aggregate, have only approximately 10 percent of that number of subscribers. In addition those IRCs are presently confined to operations in five gateway cities. Given Western Union's present monopoly position in serving directly the total U.S. data/record markets, the IRCs must be given some reasonable period of time to develop their own broad-based domestic subscriber networks in order to be viably competitive against a Western Union authorized to provide international data/record services. We therefore believe, at a minimum, there should be some reasonable moratorium period, such as five years, before Western Union is permitted to provide international service.

To sum up ITT's position Mr. Chairman, it is our view that the existing statutory framework has, by and large, led to a remarkably viable and effective competitive environment for international data/record services. We urge that this environment be maintained with only a minimum of statutory changes designed to address long-standing, specific problems which appear at this point not to lend themselves to a solution under the present regulatory structure. Those changes, in our view, would entail:

- (1) The creation of an International Facilities Planning Committee, to perform the planning function for future international facilities;
- (2) Deregulation of the process of adding new international facilities; and
- (3) The introduction of meaningful restrictions on the participation by monopoly-based carriers in the provision of competitive international data/record services.

We submit that these modifications will place the international communications industry on a very sound basis, and will be entirely consistent with the deregulatory emphasis of the domestic portions of S. 611/S. 622.

Thank you again for the opportunity of appearing before this Subcommittee to present our views on this important legislation. I will be happy to answer any questions regarding my testimony which the members or staff of this Subcommittee would like to address. We will also be happy to assist the Subcommittee and its staff by providing any additional information or proposed amendatory language that may be required.

Senator HOLLINGS. Mr. Kuyper?

STATEMENT OF DONALD M. KUYPER, GENERAL TELEPHONE & ELECTRONICS CORP.

Mr. KUYPER. I'm Donald M. Kuyper, president of Hawaiian Telephone Co., a subsidiary of General Telephone & Electronics Corp.

My testimony today on aspects of S. 611 and S. 622 pertaining to international telecommunications is on behalf of both Hawaiian Telephone and GTE.

Hawaiian Telephone enjoys a unique position among U.S. carriers. While relatively small in size, we are the only company, as a

single entity, which directly provides all three basic telephone services—local, interstate, and international.

Hawaiian is also unique because of its strategic geographical location in the middle of the Pacific. As a result, we play an important part with regard to international communications facilities in the Pacific.

Hawaiian has ownership of circuits in 7 transpacific cables which connect Hawaii with the United States mainland, Canada, Asia and the Pacific Ocean nations.

Hawaiian has been deeply involved in the planning, installation, and operation of these facilities ever since the first cable to Hawaii was installed in 1957.

Telecommunications services to the mainland are also provided via the Comstar satellite system operated by A.T. & T. and GTE Satellite Corp. In addition, Hawaiian jointly owns the Earth station delivering international traffic to the Intelstat system.

Let me begin by summarizing our views generally before turning to specific provisions of the two bills.

It has become increasingly apparent that the existing statutory provisions dealing with international telecommunications do need revision.

Hawaiian's experience with the governmental approval process concerning international facilities demonstrates the need to streamline FCC decisionmaking. In particular, we support the need for improvements with respect to facility planning. The conclusion that revision is needed is based on our 15 years of experience as active and substantial providers of international telecommunications services.

We have, however, very serious concerns with the international provisions of S. 611. This bill is being offered as a procompetitive measure, but in the international area it would, for all practical purposes, obliterate any effective private-sector role in relation to the creation and operation of international facilities.

Under S. 611 there would be formed an international facilities management corporation, which is described as not being an agency of the U.S. Government. But when the nature of this corporation, its functions, and the composition of its board of directors are examined, clearly, it is not a true private sector firm, either. I would characterize it as a kind of quasi-public, quasi-governmental entity, which would take over the international facilities decision-making that is now in the hands of competing carriers, subject to FCC review.

S. 611 accelerates the process initiated at the FCC in recent years of involving the Government in facility planning, effectively taking these decisions away from the carriers.

S. 611 is a further step in transferring to this quasi-governmental entity, planning, construction and operating responsibilities on a vast scale.

It is our opinion that the scheme of S. 611, with its facilities corporation and compulsory transfer of interests to a consortium is in no sense whatever procompetitive.

We also have some concerns with S. 622, but we are glad to see that Senator Goldwater's bill does not contemplate the kind of extraordinary result that S. 611 seems to have in mind.

In many ways, our views parallel the international provisions of the recently introduced House bill, H.R. 3333.

Let me turn now to a more specific discussion of the issues raised by these bills.

In our experience as a major participant in international facility planning, we have found that the U.S. carriers and their foreign counterparts have been able to agree on acceptable plans and arrangements through negotiation and compromise, with the help of longstanding relationships established between the carriers and their foreign partners over the years.

The principal problem in recent years has been the inability of the U.S. carriers to construct and activate international facilities to meet traffic demands because of the FCC's reluctance to grant timely authorizations. The effects of FCC practices extend even to acquisitions by Hawaiian Telephone of circuits that were constructed solely by foreign countries.

One of the reasons for this situation is that there is an entirely different and separate planning and approval process for cables as opposed to satellites. S. 611 may be intended to deal with these problems. However, the drastic measures proposed would, in our opinion, create very serious difficulties.

I have already addressed our concern with the transfer of planning and operational responsibilities, with regard to facilities, from the private sector to the international facilities management corporation. The associated requirement that the carriers turn over ownership of their facilities to a consortium creates the same kind of concerns. This concept is a kind of nationalization of a major part of the business. The present ownership arrangements with improvements in the regulatory process would, in the long run, be of more benefit to the public.

Submarine cable circuits are owned jointly with our foreign partners, and renegotiation of these agreements to turn over our interests to a consortium would be another complexity.

The facilities management corporation created by S. 611 in section 242 to plan, construct, manage and operate international facilities will also create significant additional operating expense.

What is being proposed is a very large operating entity in the international area, embracing part of A.T. & T. Long Line, Comsat and the record carriers, as well as the international elements of Hawaiian Telephone. The expenses of the corporation would go far beyond the operating costs of the facilities, as that term is generally used. There would be substantial overhead costs which go with the creation of this kind of supercorporation—officers, staff, employee benefits and pensions, for example.

Since S. 611 allocates all these costs among the carriers, the public will ultimately be required to pay for it through higher international rates. Hawaiian believes that S. 611 would greatly increase the cost of international telecommunications for all carriers and would be totally unworkable for the smaller carriers such as Hawaiian.

This is because of the serious impact the full separation requirements of section 252 would have on a company the size of Hawaiian.

This section requires full separation between the provider of domestic and international services and also between the provider of noncompetitive international public message telephone service, as opposed to the provider of other international services.

These provisions, together with those of section 205, could require us to create four or possibly five fully separated entities to handle our activities in Hawaii.

According to the definition, a fully separated entity or carrier cannot have common directors, officers, employees, financial structure or commonly owned facilities with another entity or carrier.

For Hawaiian to establish such fully separated entities would be totally impractical and, needless to say, prohibitively expensive.

Hawaiian's recently installed Western Electric No. 4 ESS switch, with its tremendous economy of scale achieved through the use of common equipment, provides switching for foreign, interstate, and local services.

As the bill is written, it could be interpreted that we would be required to install two additional machines to perform the same functions we are realizing from one. This is only an example of the problems these full separation requirements would cause for Hawaiian.

Senator Goldwater's bill, which suggests a better approach, does not adopt the consortium approach of S. 611. Clearly, S. 622 reflects a constructive attempt to improve the climate of international telecommunications.

We have to question the effectiveness of the procedure discussed in S. 622. Under section 226(c), the FCC would be even more heavily involved in facility planning matters than it is today. It seems to us that, in this respect, the task force approach of H.R. 3333 would be much more workable.

Hawaiian believes that improvements in the international planning and approval process can be accomplished in another way that would eliminate the expense of a new organization and result in less disruption of the planning and negotiating with foreign administrations.

This would be through the establishment of a task force comprised of all U.S. international carriers, including Comsat, to plan both cable and satellite facilities. This is similar to the approach proposed in H.R. 3333.

Construction and operation of facilities, planned by the task force and agreed to by the carriers' foreign partners would not require prior approval by the FCC; rather, the FCC would assume an oversight role.

We believe this arrangement, if properly implemented, would tend to reduce the extensive delays currently being experienced by the U.S. carriers. We believe this is a more practical way to solve the facility planning problem without incurring substantial additional costs.

In summary, we have to express our grave concerns with the international aspects of S. 611. We appreciate the constructive spirit of S. 622, although we are not convinced its procedural approach would improve the present situation.

There is a need for revision of the Communications Act to deal with international telecommunications in the 1980's and 1990's.

We suggest that the subcommittee consider the international provisions of H.R. 3333, which, we suggest, point in the right direction.

Revision of the Communications Act is, we believe, one of the more important matters now before the Congress. We commend the subcommittee for focusing the attention of the Senate on this critical subject, and we would be more than happy to assist in any way we can in the development of constructive revisions.

Thank you for this opportunity to appear.

Senator HOLLINGS. Thank you very much.

Mr. Weinstein?

**STATEMENT OF STANFORD B. WEINSTEIN, COUNSEL FOR
REGULATORY AFFAIRS, GRAPHNET, INC.**

Mr. WEINSTEIN. Thank you.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear here today on behalf of Graphnet, Inc., a wholly owned subsidiary of Graphic Scanning Corp., a publicly held corporation.

My name is Stanford Weinstein, and I'm counsel for regulatory affairs for Graphnet.

Because Graphnet is a relatively new carrier which you may not be completely familiar with, I would like to begin my remarks today with a very brief thumbnail description of Graphnet and the services it offers before I enter into my remarks on the bill.

Graphnet is a small but growing participant in the vast record communications field—a service marketplace directed to the electronic movement of hard-copy information.

Graphnet is also an increasingly important element in that marketplace, for it represents the leading edge of a wave of technological change and innovation in a field where traditional services have long since been overtaken by the computer revolution.

Certificated by the FCC in 1974, Graphnet was the first so-called value-added communications common carrier to begin offering services in the United States. Unlike wireline or microwave carriers, such as telephone companies, which actually string cables and build radio transmission facilities, value-added carriers generally lease their communications channels from such other carriers.

By combining those channels with specially developed computer hardware and software, value-added carriers offer communications users a wide range of innovative services.

Graphnet has twice received FCC certificate authority to provide domestic record services, and the FCC has found Graphnet's proposed services to be superior to Western Union's. Graphnet has also been granted authority to directly provide its services between the United States, on the one hand, and Canada, Mexico, and 11 Western European countries, on the other.

In this latter respect, the FCC specifically cited Graphnet's proven capability and expertise, and noted the authority it granted would extend the benefits of Graphnet's capability and expertise into the international marketplace and make available to the public the benefits inherent in its service offerings.

More recently, Graphnet has been granted authority to interconnect its domestic network with the networks of the international

record carriers, for the handling of international message traffic. In authorizing Graphnet to handle this traffic, the FCC stated that the nature and quality of international telegrams and telegraph message service will be enhanced by Graphnet's capabilities, and it is likely that the existing pattern of cost increases in this service will be halted or at a minimum, slowed by Graphnet's competitive presence.

Today, Graphnet provides a variety of nationwide specialized record communications services to the business community. Utilizing sophisticated computer techniques, Graphnet's communication system provides a speed, accuracy, and reliability of service previously unavailable.

For the first time, Graphnet has made possible communications among otherwise incompatible communications devices. A business customer's Telex terminal, for example, can now talk to a distant office's facsimile machine. Data from a CRT terminal can be output on a TWX machine.

Diverse word processing machines used in typical business office environments are now able to communicate with one another.

I've attached a chart to my statement which illustrates the variety and flexibility of Graphnet services.

Preliminarily, it should be understood that in light of its current service offerings, Graphnet's comments today are directed specifically to the record communications marketplace.

As you know, unlike voice communications, record communications are those communications in which a record or paper copy of the transmission is generated. The most familiar forms of record communication services today are telegrams, telex, TWX and various facsimile offerings.

The record communications market is a highly concentrated one. In the domestic arena, Western Union has had a virtual monopoly for over 35 years—it carries 100 percent of all domestic telegrams, and 100 percent of all domestic telex and TWX traffic. In the international marketplace, 94 percent of all record traffic is carried by only three international record carriers: RCA Global Communications, Inc., ITT World Communications, Inc., and Western Union International, Inc.

The IRC's presently make their international services available to U.S. hinterland customers through interconnection with a domestic carrier on the U.S. end of the circuit and interconnection with a foreign correspondent on the overseas side.

It is only with this industry structure in mind that meaningful comments on the proposed legislation can be made.

Senator HOLLINGS. Could you withhold, Mr. Weinstein? There is a rollcall which I must attend. Senator Schmitt will be back in just a second.

[Brief recess.]

Senator HOLLINGS. My apologies to you, Mr. Weinstein, and the panel. You may resume.

Mr. WEINSTEIN. Thank you.

Senator HOLLINGS. I think you were about to say you supported our bill. That's why I came back.

Mr. WEINSTEIN. As a general matter, Graphnet supports S. 611's basic reliance on competition, and its recourse to regulation only as necessary to carry out the purposes of the bill.

With respect to international communications, the provisions of S. 611—most notably section 241(d)—evidence a congressional desire to establish “full, fair, and effective competition and to ensure that the benefits of such competition flow primarily to consumers.”

Graphnet wholeheartedly supports this goal.

Moreover, Graphnet fully endorses the single entity concept set out in the international telecommunications portion of the bill.

However, rather than addressing those portions of the bill with which Graphnet is in agreement, I would instead like to focus my remarks on two areas where we think further attention is needed.

First, Graphnet believes that the single entity proposed by the bill—the International Facilities Management Corp.—must be given greater powers than are presently provided for.

Second, in its failure to bar the entry of the U.S. Postal Service into the communications marketplace, the Congress will insure the demise of even today's limited competition at the hands of a Government-sponsored and Government-subsidized market entrant.

Although my written statement addresses the Postal Service issues, due to the limited time available today, I do not have time to address these issues in my oral remarks.

However, it should be recognized that the Postal Service already has close relationships with foreign correspondents in every nation in the world.

Under section 244(a) of the bill, a single entity is established to, one, plan, construct, manage, and operate the U.S. segment of international transmission facilities; two, negotiate with foreign entities concerning facilities construction; three, provide assistance to U.S. carriers in establishing operating agreements with foreign entities; and four, provide transmission service to carriers which have operating agreements.

In Graphnet's view, this section makes clear the bill's intent to delegate to this single entity total responsibility for dealing with foreign entities concerning facilities construction and management.

We concur in this approach.

With respect to the establishment of operating segments, however, the bill takes a completely different approach. In this regard, it gives the single entity the power only to assist multiple U.S. carriers in negotiating individual operating agreements.

We do not believe this will serve the interests of the United States. Rather, we believe the single entity should have the responsibility for negotiating operating agreements with all foreign countries.

All international negotiations must be undertaken by this entity on behalf of all U.S. carriers—both for facilities construction and for the establishment and maintenance of operating agreements.

It is not enough for this single entity to merely assist U.S. carriers in establishing their own separate operating agreements with foreign administrations. The United States will have far more influence and leverage in international negotiations if it speaks with one voice for all U.S. carriers.

Moreover, we believe foreign administrations would be more willing to enter into one master operating agreement covering all U.S. carriers than to negotiate a separate agreement for each.

Under Graphnet's proposal, all U.S. carriers could avail themselves of the master operating agreements negotiated by the single entity. As a result, all U.S. carriers would have equal access to international facilities and foreign administrations, both of which are needed for the successful marketing of international services.

With such equal access assured, all U.S. carriers could compete on equal terms, and the public would reap the benefits of a truly competitive marketplace.

Under Graphnet's proposal, a domestic carrier seeking to provide international services could do so in one of three ways: First, it could acquire an ownership interest in international facilities through the consortium as provided for in section 246 and directly interconnect with foreign correspondents; second, it could interconnect with an international carrier on a division of revenues basis as is the current practice with Western Union and the IRC's; third, it could lease international facilities from an international carrier for resale to the public, as is the current practice with the international carriers and Comsat.

The free forces of the marketplace and the nature of the services to be provided will control which method will be used. Regulatory intervention will not be required.

Several provisions of the proposed legislation appear to be premised on the assumption that a truly competitive marketplace for international services can never be achieved. Our proposal, however, would assure the development of a competitive international marketplace, and thus, would permit the elimination or simplification of certain provisions.

For example, section 251(a)(1) requires international carriers to offer nondiscriminatory interconnection to domestic carriers upon reasonable request. Because of the choices available to domestic U.S. carriers under Graphnet's proposal, this would not be necessary. With equal access to foreign administrations, domestic carriers could merely bypass recalcitrant international carriers.

Similarly, section 252(a) requires that domestic and international services be provided by fully separated entities. Again, in a competitive marketplace where all carriers have equal access to foreign administrations, such a separation would be unnecessary.

This provision could be eliminated.

In conclusion, Graphnet believes that the Congress can and should establish a market structure which will ensure the development of full and fair competition for both domestic and international record communications services.

To accomplish this, a single U.S. entity must be established which will be responsible for not only the planning, construction, management, and operation of the U.S. portion of all international facilities—as the bill now provides—but will also have the responsibility for negotiating and implementing operating agreements with all foreign countries on behalf of all U.S. carriers.

Only if this further authority is added in the bill can a truly competitive record communications market be established.

Thank you. My prepared statement also addresses the Postal Service issues.

[The statement follows:]

STATEMENT OF STANFORD B. WEINSTEIN, COUNSEL FOR REGULATORY AFFAIRS, ON BEHALF OF GRAPHNET, INC.

Mr. Chairman and members of the subcommittee, I appreciate the opportunity to appear today on behalf of Graphnet, Inc., a wholly-owned subsidiary of Graphic Scanning Corp., a publicly-held corporation. My name is Stanford Weinstein, and I am Counsel for Regulatory Affairs for Graphnet, Inc.

GRAPHNET'S COMMUNICATIONS SERVICES

Graphnet is a small but growing participant in the vast record communications field—a service marketplace directed to the electronic movement of hard-copy information. Graphnet is also an increasingly important element in that marketplace, for it represents the leading edge of a wave of technological change and innovation in a field where traditional services have long since been overtaken by the computer revolution.

Certificated by the Federal Communications Commission in 1974, Graphnet was the first so-called "value-added" communications common carrier to begin offering services in the United States. Unlike wireline or microwave carriers, such as telephone companies, which actually string cables and build radio transmission facilities, "value-added" carriers generally lease their communications channels from such other carriers. By combining those channels with specially-developed computer hardware and software, "value-added" carriers offer communications users a wide range of innovative services.

Graphnet has twice received FCC certificate authority to provide domestic record services, and the FCC has found Graphnet's proposed services to be superior to Western Union's. Graphnet has also been granted authority to directly provide its services between the United States, on the one hand, and Canada, Mexico and eleven Western European countries, on the other. In this latter respect, the FCC specifically cited Graphnet's "proven capability and expertise", and noted the authority it granted "would extend the benefits of [Graphnet's] capability and expertise into" the international marketplace and "make available to the public the benefits inherent in [its] service offerings." More recently, Graphnet has been granted authority to interconnect its domestic network with the networks of the international record carriers, for the handling of international message traffic. In authorizing Graphnet to handle this traffic, the FCC stated that "[t]he nature and quality of international telegrams and telegraph message service will be enhanced by Graphnet's capabilities, [and] it is likely that the existing pattern of cost increases in this service will be halted or at a minimum slowed by Graphnet's competitive presence."

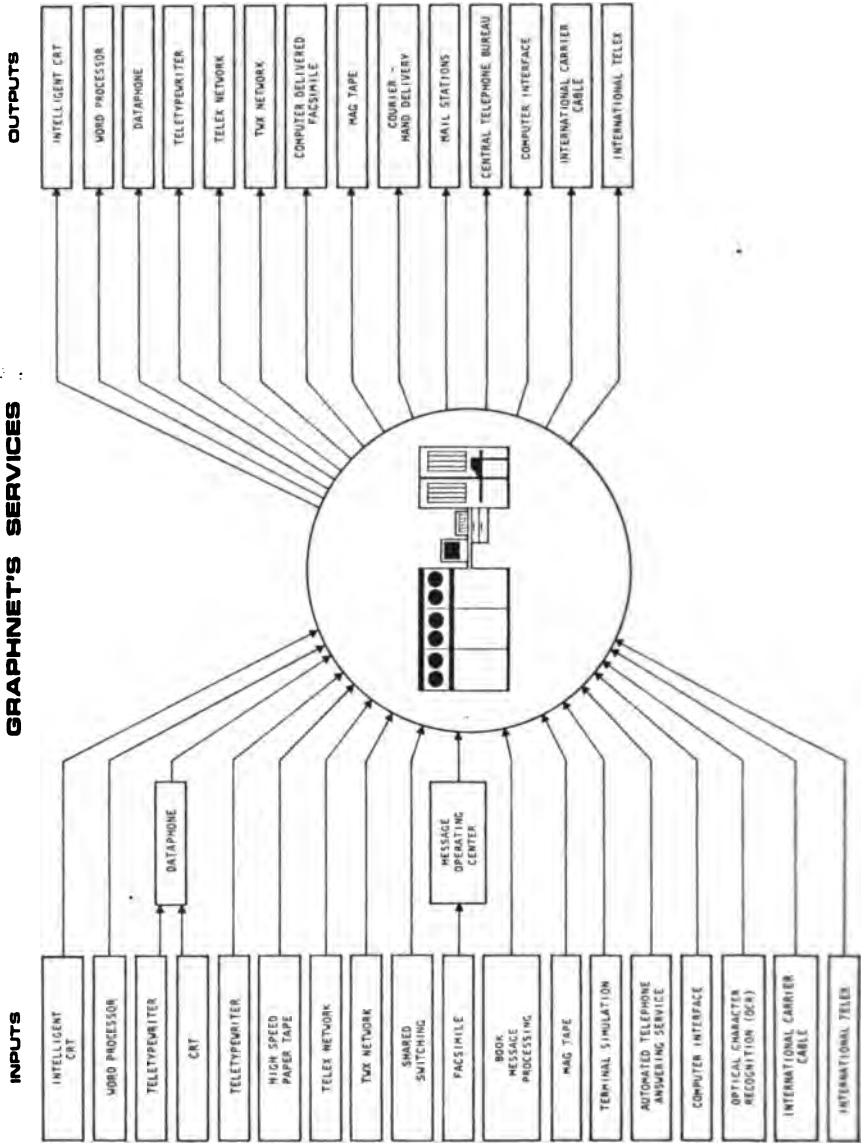
Today, Graphnet provides a variety of nationwide specialized record communications services to the business community. Utilizing sophisticated computer techniques, Graphnet's communication system provides a speed, accuracy, and reliability of service previously unavailable. The Graphnet system is user-oriented. Unlike established common carriers, which have developed networks which require their users to adapt their communications needs to the operating criteria of such networks, Graphnet's system is designed and engineered to afford each customer substantial flexibility to satisfy his particular communications requirements.

Graphnet's services permit a customer to transmit information from diverse sources, including computers, Telex and TWX terminals, visual display terminals (CRTs), word processing devices and various types of facsimile transceivers, and to send this information, through Graphnet's network, to virtually any type of receiving terminal device or computer at any addressee location within the contiguous 48 states. For the first time, Graphnet has made possible communications among more than a million otherwise incompatible communications terminal devices in the United States and abroad. Thus, a business customer's Telex terminal, for example, can now "talk to" a distant office's facsimile machine. Data from a CRT terminal can be output on a TWX machine. Diverse word-processing machines used in typical business office environments are now able to communicate with one another. The variety and flexibility of Graphnet's services are illustrated by the chart on the following page.

Where no terminal is available at the addressee's location, subscribers may send their messages directly to Graphnet. Using its network services, Graphnet will then transmit the messages through its network and deliver the messages by courier, mail or telephone, depending on the sender's instructions. These Graphnet services

compete most directly with Western Union's telegram and Mailgram services and the Postal Service's proposed ECOM service.

The Graphnet subscriber may access the system at any time on a demand basis and may select the particular service features which he needs. For example, a subscriber can input information only once and this data can be automatically transmitted to a large number of addressees regardless of the diverse character of the designated receiving devices involved. Information already accepted by the system will be automatically routed to an alternative receiving terminal if the originally addressed terminal is unavailable for a specified time period. The subscriber is charged primarily according to the amount of data transmitted independent of the distance transversed. Graphnet's services truly represent a new dimension in the movement of business information.



THE RECORD COMMUNICATIONS SERVICES MARKETPLACE

Preliminarily, it should be understood that, in light of its current service offerings, Graphnet's comments today are directed specifically to the record communications marketplace. As you know, unlike voice communications, record communications are those communications in which a record or paper copy of the transmission is generated. The most familiar forms of record communication services today are telegrams, telex, TWX and various facsimile offerings.

The record communications market is a highly concentrated one. In the domestic arena, Western Union has had a virtual monopoly for over 35 years—it carries 100 percent of all domestic telegrams, and 100 percent of all domestic telex and TWX traffic. In the international marketplace, 94 percent of all record traffic is carried by only three international record carriers (IRCs)—RCA Global Communications, Inc., ITT World Communications Inc. and Western Union International, Inc. The IRCs presently make their international services available to U.S. hinterland customers through interconnection with domestic carrier on the U.S. side and interconnection with a foreign correspondent on the overseas side. It is only with this industry structure in mind that meaningful comments on the proposed legislation can be made.

S. 611 AND RECORD COMMUNICATIONS SERVICES

As a general matter, Graphnet supports S. 611's basic reliance on competition, and its recourse to regulation only as necessary to carry out the purposes of the Bill. With respect to international communications, the provisions of S. 611—most notably Section 241(d)—evidence a Congressional desire to establish "full, fair, and effective competition . . . [and] to ensure that the benefits of such competition flow primarily to consumers." Graphnet wholeheartedly supports this goal. Moreover, Graphnet fully endorses the single entity concept set out in the international telecommunications portion of the Bill (Sections 240-253).

However, rather than addressing those portions of the Bill with which Graphnet is in agreement, I would instead like to focus my remarks on two areas where we think further attention is needed. First, Graphnet believes that the single entity proposed by the bill—the International Facilities Management Corporation—must be given greater powers than are presently provided for. Second, in its failure to bar the entry of the U.S. Postal Service into the communications marketplace, the Congress will insure the demise of even today's limited competition, at the hands of a government sponsored and government-subsidized market entrant.

International telecommunications

Under Section 244(a) of the Bill, a single entity is established to (1) plan, construct, manage, and operate the United States segment of international transmission facilities, (2) negotiate with foreign entities concerning facilities construction, (3) provide assistance to U.S. carriers in establishing operating agreements with foreign entities, and (4) provide transmission service to carriers which have operating agreements. In Graphnet's view, this section makes clear the Bill's intent to delegate to this single entity total responsibility for dealing with foreign entities concerning facilities construction and management. We concur in this approach.

With respect to the establishment of operating agreements, however, the Bill takes a completely different approach. In this regard, it gives the single entity the power only to assist multiple U.S. carriers in negotiating individual operating agreements. We do not believe this will serve the interests of the United States. Rather, we believe the single entity should have the responsibility for negotiating and implementing operating agreements with all foreign countries. All international negotiations must be undertaken by this entity on behalf of all United States carriers—both for facilities construction and for the establishment and maintenance of operating agreements.

It is not enough for this single entity to merely assist United States carriers in establishing their own separate operating agreements with foreign administrations. The United States will have far more influence and leverage in international negotiations if it speaks with one voice for all U.S. carriers. Moreover, we believe foreign administrations would be more willing to enter into one "master" operating agreement covering all U.S. carriers than to negotiate a separate agreement for each.

Under Graphnet's proposal, all United States carriers could avail themselves of the "master" operating agreements negotiated by the single entity. As a result, all U.S. carriers would have equal access to international facilities and foreign administrations, both of which are needed for the successful marketing of international services. With such equal access assured, all U.S. carriers could compete on equal terms, and the public would reap the benefits of a truly competitive marketplace.

Under Graphnet's proposal, a domestic carrier seeking to provide international services could do so in one of three ways: (1) acquire an ownership interest in international facilities (through the consortium as provided for in Section 246) and directly interconnect with foreign correspondents; (2) interconnect with an international carrier on a division of revenues basis (as is the current practice with Western Union and the IRCs); or (3) lease international facilities from an international carrier for resale to the public (as is the current practice with the international carriers and Comsat). The free forces of the marketplace and the nature of the services to be provided will control which method will be used. Regulatory intervention will not be required.

Several provisions of the proposed legislation appear to be premised on the assumption that a truly competitive marketplace for international services can never be achieved. Our proposal, however, would assure the development of a competitive international marketplace, and thus would permit the elimination or simplification of certain provisions.

For example, Section 251(a)(1) requires international carriers to offer nondiscriminatory interconnection to domestic carriers upon reasonable request. Because of the choices available to domestic U.S. carriers under Graphnet's proposal, this would not be necessary. With equal access to foreign administrations, domestic carriers could merely bypass recalcitrant international carriers.

Similarly, Section 252(a) requires that domestic and international services be provided by full separated entities. Again, in a competitive marketplace where all carriers have equal access to foreign administrations, such a separation would be unnecessary. This provision could be eliminated.

In conclusion, Graphnet believes that the Congress can and should establish a market structure which will insure the development of full and fair competition for both domestic and international record communications services. To accomplish this, a single United States entity must be established which will be responsible for not only the planning, construction, management, and operation of the United States portion of all international facilities—as the Bill now provides—but will also have the responsibility for negotiating and implementing operating agreements with all foreign countries on behalf of all U.S. carriers. Only if this further authority is added in the Bill can a truly competitive record communications market be established.

The U.S. Postal Service and Electronic Communications Services

Section 103(35) of S. 611 defines "telecommunications carrier" as "any person or any subsidiary of such person, including any government or quasi-government entity, engaged in the offering of telecommunications services for hire. . . ." In Graphnet's view, this definition makes clear the Bill's intent to subject the U.S. Postal Service to the regulatory oversight of the FCC. But it is not enough to have the FCC regulate the Postal Service. Rather, Congress must make clear that the Postal Service will not be allowed to offer any form of electronic communications service.

Within the past year, the Postal Service has taken affirmative steps to enter both the domestic and international record communications markets through the offering of its own electronic message services in direct competition with private industry. Its domestic service is known as ECOM (Electronic Computer Originated Mail) and its international service is known as Intelpost (International Electronic Post).

By way of background, it is important to distinguish between mail services and electronic message services. There has been much talk recently about the convergence of "mail" and "electronic communications", and this convergence has often been referred to as "electronic mail." The use of the term "electronic mail" is inappropriate, since it needlessly confuses the distinction between mail services and electronic communications services, and further presupposes that such services are within the domain of the Postal Service.

Mail services constitute the pick-up, transportation, and delivery of letters, packets, post cards, parcels, etc. In each case, the service entails the movement of physical objects. Whatever its form, the physical object which is picked up by the Postal Service is the same physical object which is transported and delivered to the recipient. Communications services, however, involve the electronic transmission of information. When a carrier undertakes to transmit information on a per message basis, such service is properly referred to as an "electronic message service." Western Union's telegram and Mailgram services, Graphnet's FAX GRAM services, and the Postal Service's proposed ECOM and Intelpost services are all merely different variations of electronic message services.

The significance of the ECOM and Intelpost offerings is that they represent the first large-scale attempts by the Postal Service to offer electronic message services directly to the public. It should be recognized that the offering of these services

would be a major change in the Postal Service's traditional role. It is not just the inauguration of new types of mail services, as ECOM has been portrayed at the Postal Rate Commission; it is the beginning of the Postal Service's entry into the communications marketplace.

Numerous important legal, technical, financial and policy issues are raised by the potential entry of the Postal Service into the electronic message service marketplace. These issues are not merely academic questions. With respect to the Postal Service's first attempt to offer an electronic message service—ECOM—the Postal Service estimates that, by the second full year of operation, ECOM will carry 35 million messages. Furthermore, when fully developed, the market potential for ECOM is enormous. The Postal Service has estimated the annual ECOM potential market at 15.6 billion messages! By comparison, in 1977, Western Union's total message volume was only 31 million messages. As can be seen, ECOM volumes will far exceed this in only two years, and the total ECOM market is anticipated to grow so rapidly that it will soon reach a level three orders of magnitude larger than present message volumes.

The impact of ECOM and other electronic message services on the communications industry will be substantial. Over the past several years, the FCC has adopted a series of policy decisions which have introduced competition in the common carrier industry. The benefits to the public of these decisions are manifold and need not be repeated here. However, it should be recognized that the entry of the Postal Service, with its government sponsored subsidies, into the message communications market, adds a new dimension to the market not previously considered, by either the FCC or the Congress.

At the outset, Graphnet wishes to reemphasize that it does not oppose competition per se so long as it is full and fair competition. But any competition between the Postal Service and private enterprise would inherently be unfair and anticompetitive for several reasons.

To begin with, the establishment and operation of a nationwide communications network requires a tremendous investment. Private enterprise must go to the stock and bond markets for long term financing of its operations. Today capital is in short supply, and when available, interest rates are high. This cost of capital forms a significant part of the cost of operating a private enterprise. The Postal Service, on the other hand, need not consider the cost of capital; it receives its financing from Congressional appropriations.

The Postal Service's entry into the communications marketplace would have a chilling effect on the availability of capital. Potential investors would see the entry of the Postal Service as a substantial heightening of the risk involved in the private enterprise, and thus would demand a higher return on their investment to compensate them for the substantially higher risk. Thus the entry of the Postal Service into the marketplace could result in the cost of capital—which is high under normal circumstances—being raised to prohibitively high levels.

Another significant cost of doing business is state and Federal income taxes. For corporate enterprises, this consumes 48 percent of all the profits. Of course, the Postal Service, being a government entity, pays no income taxes, and therefore, gains another significant edge over private enterprise.

In addition to the financial advantages noted above, the Postal Service's entry into the communications marketplace would raise a veritable nightmare of regulatory problems. Chief among these would be the development of a costing methodology which would assure that the Postal Service's various services—mail services and communications services, monopoly services and competitive services—are priced fairly and equitably. Because the Postal Service would be offering both monopoly and competitive services, it would have the ability and the incentive to subsidize its competitive services with its monopoly revenues. Regulatory intervention will be required to prevent such cross-subsidies.

The FCC has grappled with just such a problem in its attempts to regulate AT&T. After over 12 years of hearings, the FCC finally issued its policy decision on the proper costing methodology. In the more than two years since that decision was issued, the FCC has yet to adopt a cost allocations manual or an in-depth Uniform System of Accounts—both of which are required to effectively implement its two year old policy decision. Current estimates are that it will take another 5 years to complete this task. Thus, from beginning to end, it will have taken the FCC over 19 years to establish and implement an effective system of cost-based regulation. As difficult as the AT&T regulatory issues have been, they pale by comparison of the potential regulatory problems raised by the Postal Service's entry into the communications marketplace. Notwithstanding their difficulty, however, these issues must be resolved should the Postal Service be allowed to compete in the communications marketplace.

In addition to the inherent difficulties of private enterprise competing with a government entity, discussed above, the offering of electronic message services by the Postal Service raises a host of other issues regarding potential anticompetitive conduct. These issues stem basically from the overall dominance of the Postal Service and its monopoly control of local mail distribution facilities. The entrenched position of the Postal Service here is not unlike the position of AT&T in the voice communications market, with its control of local telephone distribution facilities through its ownership of local telephone companies. The problem arises because one competitor has monopoly control over facilities whose use is required by the other competitors in the same market.

The numerous issues concerning inherent unfair advantages and potential anti-competitive conduct are addressed to problems raised by Postal Service competition with private enterprise. An even greater fear, however, is raised by the potential for the Postal Service to enlarge its monopoly through application of the Private Express Statutes to electronic message services. Notwithstanding the FCC's efforts to adopt policies favoring competition in specialized communications markets, including electronic message services, the Postal Service could attempt to apply the Private Express Statutes to these services to prevent others from offering them. Thus, by administrative fiat, the Postal Service could reverse a long series of the FCC's decisions, and eliminate the very competition the FCC has sought to establish.

Two separate and distinct Private Express Statute issues are relevant to electronic message services. First, if the Postal Service begins offering its own electronic message services, then it might take the position that all aspects of competitive services are subject to the Private Express Statutes and that no private entities can offer such competitive services.

Even if it is eventually decided that the Postal Service will not offer electronic message services, the potential application of the Private Express Statutes must still be considered. The Postal Service has already begun investigating Graphnet's messenger-delivered FAX GRAM service, looking towards the application of the Private Express Statutes to this service.

The important point here is that the Postal Service, even in advance of its entry into the marketplace, is already attempting to enforce the Private Express Statutes against private entities offering electronic message services. Its attempt to enforce the Private Express Statutes against Graphnet is outrageous when one considers that the service being questioned by the Postal Service is the very same service which the FCC has specifically authorized and found to serve the public interest.

In addition, in a December 28, 1978 Notice of Proposed Rulemaking, the Postal Service has already announced its intention to broaden the application of the Private Express Statutes by a further tightening of the telegram exemption. As stated in the notice:

The clarifying change proposed here would define the term by limiting it to telegrams as commonly sent in the past by members of the public. Such a limitation seems consistent with an exclusion that is based on implications surrounding the growth of a public telegram service during the late nineteenth and early twentieth centuries that is different from other types of electronic message services that have developed recently. 43 Fed. Reg. 60615 (1978).

The so called "clarifying change", rather than supporting a competitive marketplace, would instead destroy it.

Graphnet favors full and fair competition. However, entry of the Postal Service into the electronic message service marketplace would distort and certainly destroy any competition in this market. Where numerous private entities are ready, willing and able to meet the public's needs—as is the case here—there is no justification for allowing government competition or creating a government monopoly. A governmental corporation supported by tax subsidies should be resorted to only where there is an overriding public interest justification and private enterprise is not meeting that need. Such is not the case here, and therefore the Postal Service should not be allowed to offer any form of electronic message service.

Senator HOLLINGS. Mr. Weinstein, let me ask you to go ahead and elaborate on the Postal Service issues. You say the Postal Service should be allowed to get in this. You can summarize. Your statement will be included in its entirety.

Mr. WEINSTEIN. Let me pick a couple of passages out of my prepared statement which I think would summarize our position fairly well.

As I'm sure you're aware, within the past year the Postal Service has taken affirmative steps to enter both the domestic and international record communications markets, with the offering of its own electronic message services in direct competition with private industry. Its domestic service is known as ECOM and its international service is known as Intelpost.

The significance of the ECOM and Intelpost offerings is that they represent the first large-scale attempt by the Postal Service to offer electronic message services directly to the public. It should be recognized that the offering of these services will be a major role change for the Postal Service. It is not just the inauguration of new types of mail services, as ECOM has been portrayed at the Postal Rate Commission. It is the beginning of the Postal Service's entry into the communications marketplace.

The impact of ECOM and other electronic message services on the communications industry will be substantial. Over the past several years, the FCC has adopted a series of policy decisions which have introduced competition in the common carrier industry. The benefits to the public of these decisions are manifold, and I need not repeat them here.

However, it should be recognized that the entry of the Postal Service into this market, with its Government-sponsored subsidies, adds a new dimension to the market not previously considered by the FCC or by the Congress.

Now, at the outset I want to emphasize that Graphnet does not oppose competition per se, so long as it is full and fair competition. But any competition between the Postal Service and private enterprise would inherently be unfair and anticompetitive, for several reasons. Many of these reasons are addressed in my written statement, and I won't repeat them now.

I would like to close by mentioning a few words about the private express statutes.

Senator SCHMITT. Mr. Chairman, would the witness stop for a moment and if the chairman would yield.

You and I both have expressed a great deal of interest in the issue of the Postal Service competing in the offering of record carrier telecommunications services. Although last year we had hearings and considerable discussion on it, the issue has remained unresolved. Since we are both on the Appropriations Committee, I hope that you and I can discuss this, because obviously the perception of the private sector is that the Postal Service is moving in to offer competitive services. Certainly that has not been the intent of the Congress. The issue has not been fully debated, and there is no legislative guidance in this area that is of any significance.

This witness made an excellent statement on the issue, and we ought to pay some attention to it as we go forward this year.

I am very disturbed, as you are, by the movement of the Postal Service into these kinds of services without any express authorization. Even though they call it an experiment, it happens to be almost identical to commercial services that are being offered by other entities. I don't call that an experiment; I call that an intrusion.

Mr. WEINSTEIN. Well, I thank you for your comments. I would agree with that. In fact, I have a copy of the report on the hearings

that were held before this very subcommittee last year on S. 3229, and at those hearings Mr. Bolger, the Postmaster General, appeared and he made the statement in those hearings that:

"The Postal Service firmly believes that if the private sector would be ready, willing and able, that the Government most likely should stay out of this."

Notwithstanding his statement last fall before this committee, the Postal Service certainly has moved ahead with great speed in the Postal Rate Commission with its ECOM proposal and also with its international Intelpost proposal, for which they do not need regulatory approval from the Postal Rate Commission.

Graphnet has filed numerous pleadings and briefs before both the Postal Rate Commission and the FCC addressing the issues, the regulatory, jurisdictional, legal and policy issues. However, we feel that certainly this is an issue which is of such great importance that it has to be addressed by the Congress and not merely by the regulatory agencies which are involved at this time.

I have every reason to believe that we will probably end up with conflicting decisions coming out of the Postal Rate Commission and the FCC at such time as they both reach their decisions, which will probably be in the near future.

Senator HOLLINGS. What are the views of the other panelists? Mr. Kuyper, Mr. Knapp, do you have a feel or an opinion with regard to the Postal Service entering the electronic mail carrier service?

Mr. KNAPP. Mr. Chairman, we believe that the telecommunication carriers can provide to the Post Office the means whereby electronic mail would be furthered. But we think the carriers themselves can provide that service to the Post Office.

We see no reason for the Post Office to begin to build new systems to do that. We believe that can be done very well by the competing carriers.

Senator HOLLINGS. Mr. Kuyper?

Mr. KUYPER. I would also concur with that and say that the Post Office moving into record communications on a directly competitive basis would be an extreme burden on the carriers.

Senator HOLLINGS. Let me ask, Mr. Weinstein, about the consultative process. Does that work or not? What is your comment?

Mr. WEINSTEIN. Well, I can best comment on that by recounting the history of Graphnet's efforts to offer international services. In January 1977—that is more than 2 years ago—the FCC authorized Graphnet to expand its domestic offering into the international communications arena.

While that was over 2 years ago, Graphnet has still not been able to negotiate an operating agreement with any foreign country. We are, as a result, not offering any international services.

Senator HOLLINGS. What assistance did you get from the FCC? They said they had quite a bit of persuasive powers, leverage, they call it. Have you seen that employed at all?

Mr. WEINSTEIN. I heard the statement that was made this morning. Before I heard that statement, I was not aware of it. I have not seen the results of any efforts on behalf of the FCC with foreign entities.

Senator HOLLINGS. They have not attempted to bring any leverage on your behalf, as far as you know?

Mr. WEINSTEIN. As far as I know, they have not. I'm not sure that they are necessarily in a position, as a regulatory agency, to do that, either. And that is precisely why we have suggested that the single entity in the bill should have the additional power to negotiate these foreign operating agreements on behalf of Graphnet and all the future Graphnets that I expect will be appearing on the horizon as a result of the FCC's procompetitive policies.

Senator HOLLINGS. Mr. Kuyper, you were talking about the task force approach in the House bill. What binding effect would a task force have?

I think one witness brought up the committee, and another one said we ought to go along with the task force. What kind of binding nature would that have at all on the planning and purchasing and everything else of that kind of telecommunications, and bring about the economies of scale to benefit the consumers that we all say we all stand for? How would the committee have any effect whatsoever on what we find wrong now?

Mr. KUYPER. Well, we have found in our relationships with foreign entities that if you are in a position to offer something that is compatible with their views and is of value to them, that arrangements can be worked out, and the entities then work out their respective investments and respective commitments, and agreements are signed and actions take place.

The activities in the Pacific have been on a very amicable level. I might add that Hawaiian negotiated some six or seven agreements directly with European countries in the past year. To the degree that those entities felt it was in their interest and our interest to enter those agreements, they did so.

The difficulty I would see with some single entity trying to leverage these situations is that it could cause as much adverse reaction as to try to further some of these ends in a leverage manner. I think there is a need to have a great deal of consideration for the views of these foreign entities, and when that is done we have found that mutual agreements can be reached.

Senator HOLLINGS. Well, how about you, Mr. Knapp? You suggested a committee, I believe, in your testimony.

Mr. KNAPP. That's right, Mr. Chairman. I guess I would have to take a different position from Mr. Weinstein on this whole matter. I don't understand his concept of competition. There is nothing better for getting the competitive juices going than coming up with a new service or a new offering and being able to go out and negotiate with a foreign administration to be the first carrier to offer that kind of service, to the benefit of the subscribers—to the benefit, I think, of subscribers on both sides of the oceans.

I want to correct, I think, what you probably have as a misimpression in Mr. Weinstein's statement. There are indeed many domestic services today provided by U.S. domestic carriers that are being offered overseas through the carriers that have the agreements with the foreign administrations.

In fact, we have an agreement with Graphnet—I don't know whether we have any traffic from it at the moment, but we have an agreement with Graphnet to provide Graphnet's services inter-

nationally. That has been negotiated and Graphnet's services can, when Graphnet so desires, flow to every country in the world.

Senator HOLLINGS. What you're saying is there is no demand?

Mr. KNAPP. As a matter of fact, in the case of Telenet and Tymnet, all the carriers are now providing, through agreements with respect to foreign administrations, a variety of their services overseas. There are probably 40 or 50 agreements now worked out for very valuable data base services. The United States has literally dozens and dozens of data bases in all technologies, science and legal areas, that the rest of the world is desirous of accessing, and we are today, indeed, offering through the cooperation of domestic carriers, not necessarily Graphnet, but certainly Tymnet, Telenet, these services internationally, to the benefit of, I think, many subscribers.

So I think that we are able to satisfy the worldwide needs for data record services, in spite of the fact that additional domestic U.S. carriers may be having some difficulties getting agreements with foreign administrations. But let me tell you, the services are being provided.

Senator HOLLINGS. Well, Mr. Weinstein, would you clarify in my mind on that score? Why in the first instance would you have to go through ITT, but otherwise, when you do go through them, he says the services are offered and there is no demand for them. What is your comment?

Mr. WEINSTEIN. Well, actually, I have several points to make. First of all, it is true that Graphnet has an interconnection agreement with ITT. However, that has not been for the provision of all Graphnet services. That is for the provision of only international cablegram services, which is but one of our variety of services which Graphnet Systems is capable of handling.

The services which Graphnet offers domestically are not offered internationally by any other carrier under any situation. With respect to Telenet and Time-Share, neither of those companies offers international communications services. Telenet is in the exact same situation that Graphnet is in right now. They have not signed operating agreements with any foreign administration.

With respect to interconnection, yes, some U.S. carriers do in fact interconnect with international U.S. carriers for the ultimate provision of their services overseas, and in fact that is precisely what Graphnet is undertaking to do with ITT and in fact, also with RCA and Western Union International. However, Graphnet is not satisfied to merely interconnect its services with those of the international carriers and be limited by the innovation of the international carriers. We want to go direct to the foreign countries.

We want to compete with the international carriers. We're not satisfied with the status quo. And I think if there is anything that sets Graphnet apart from all the other statements you've heard today and that you will probably hear tomorrow, we are not in favor of the status quo at all. We want it to change.

Senator HOLLINGS. Well, Mr. Knapp suggested this morning that your rate of return was 50 percent. Is that correct?

Mr. KNAPP. I think the witness from Western Union had some information that I am not privy to. We filed almost a year and a half or two years ago with the FCC, the same as all international

carriers, both voice and record data, information concerning the earnings of each of our services. To my recollection—and I don't have the study with me, to be precise—to my recollection, we filed at that time that our Telex was earning somewhere in the high 20-percent range, while some of our other services were actually marginal or even losing money.

I would remind you, Mr. Chairman, that historically the FCC has urged that public message telegraph service rates be kept as low as possible, in the public interest, for the benefit of the consumer. Therefore, to have a viable total operation, the earnings from one service to another will necessarily vary, with message telegram service being quite low or I believe it could even be considered to be in a losing position, whereas Telex is, in effect, cross-subsidizing message telegrams. And that, I believe, was the explanation that the Western Union witness did not address.

Senator HOLLINGS. How about your rate of return, Mr. Weinstein? What is it for Graphnet?

Mr. WEINSTEIN. I really don't know what our rate of return is, and the reason is because Graphnet is a wholly owned subsidiary of a larger company, which is a publicly held corporation. Graphnet does not compile that information on a regular basis.

One thing I can say, however, is that if this bill is adopted with the minor change that Graphnet has suggested in our testimony today, I would like you to invite us back 5 years from now—and not only Graphnet, but all the other carriers that are going to be providing service. Five years from now let's see what the rates are.

I guarantee you some things are going to change. They will be going down considerably, notwithstanding anybody's rate of return. Because the rate of return in a competitive marketplace is really not the test. The test is what the consumers are getting for their money, and they will be getting more for their money, much more, and more for less money, as well.

Senator HOLLINGS. Senator Schmitt?

Senator SCHMITT. Thank you, Mr. Chairman.

Mr. Weinstein, isn't the basic problem that foreign entities are equivalent to foreign governments, in that even if you can—negotiate agreements with the record carriers, that you have got to have that foreign government or foreign entity, which is equivalent to a foreign government, willing to have your service come into their country?

Mr. WEINSTEIN. Yes.

Senator SCHMITT. That doesn't sound like something that is really an FCC problem or a record carrier problem. It is a problem for the State Department or the President in twisting some arms with respect to other types of international relationships. Isn't that the case?

Mr. WEINSTEIN. Yes, I think I would tend to agree with you. I think that the problem is one that is beyond the scope of the FCC's authority now.

Senator SCHMITT. Unless we're willing to come up with some mechanism by which the United States can use leverage on these foreign entities isn't this issue beyond the scope of the specific legislation we're discussing?

Mr. WEINSTEIN. Well, yes, you are right to a certain extent. But of course, your question has a big "if" in front of it: We can leverage the foreign countries. The situation today is that the leverage is going the other way. You have a monopoly on the foreign side that is dealing with multiple U.S. carriers, and they are playing the U.S. carriers off against each other.

If we have one entity on the U.S. side, dealing with the single entity that is already on the foreign side, then to that extent we would be negotiating one on one. But furthermore, U.S. carriers carry far more traffic than anyone else in the world. We do have a lot of leverage if we speak with one voice.

Let me give you an example of how that might work. Let's say you want to go to France. Let's say you are trying to negotiate an agreement with France for a new service. Some new domestic U.S. carrier has come up with a fancy service they would like to offer internationally, and the foreign country, for some reason or another, may not feel that that is a proper service. Maybe that's going to lower the cost too much, and perhaps they don't want it to compete with the already established services.

If one country is unwilling to enter into an agreement, then the United States can take all its traffic to another country. There are a lot of different ways you can route traffic to Europe, for instance. As an example, if you're trying to negotiate an agreement with France and they are recalcitrant, then you go to Germany and you offer Germany the totality of U.S. traffic.

That is an awful lot of leverage. Now, I'm not saying you have to go to that sort of an extreme. I doubt that it would get to that point. But nonetheless, the United States has a tremendous amount of leverage if it speaks with one voice on behalf of all U.S. carriers, on behalf of all U.S. traffic. We have most of the traffic in the world coming in and out of this country.

Senator SCHMITT. Mr. Knapp?

Mr. KNAPP. Senator Schmitt, I must take extreme exception to the proposal by Mr. Weinstein. I think what we're suggesting here, or what Mr. Weinstein is suggesting, is a legislative blackmail of a foreign administration. I think that would just be an abomination. That is just wholly unrealistic in the political world today or the international world today. And I would oppose it strongly.

We have seen, in some of the consultative, "consultative," meetings between the CEPT nations and the FCC, where I think the goodwill of those CEPT nations was put to a test by some very, very arrogant behavior on the part of the FCC. And I think that, in the limited conversations I have had with the State Department, that this has caused some serious problems for the United States.

Senator SCHMITT. Well, Mr. Knapp, is there an alternative—

Mr. KNAPP. Certainly.

Senator SCHMITT [continuing]. To creating a monopoly situation internationally? You recognize there is a problem. Graphnet has a problem dealing with foreign entities, right? They may have excellent service, and if a country doesn't want that service or they want to deal with someone else, that foreign entity has the ultimate discretion to exclude Graphnet. Right?

Mr. KNAPP. But it is not an insolvable problem.

Senator SCHMITT. What is your alternative?

Mr. KNAPP. I would refer you to the case of Tropical Radio. Tropical Radio was a regional international record carrier in the Caribbean and South America. In the last 3 or 4 years, it has grown from virtually no share of telex market internationally to a 5-percent share of the telex market, and it has done this through negotiations directly with the foreign administrations.

It doesn't go rapidly, but it does work. And TRT is becoming a very, very viable international record data carrier. And I fully appreciate that perhaps some of the administrations overseas move somewhat slowly. But they do that for very good reasons, very good national reasons within their own particular political entity. And I don't see how this Congress can accept Mr. Weinstein's proposal to legislate, in effect, blackmail, and that is what it would be.

Senator SCHMITT. Mr. Weinstein, how many employees does Graphnet have?

Mr. WEINSTEIN. Graphnet? Well, I can give you Graphic Scanning, which is the umbrella for Graphnet, has revenues of about \$30 million now a year, which are growing at about 25 percent a year.

Senator SCHMITT. Does Graphic Scanning do the international negotiating for Graphnet?

Mr. WEINSTEIN. No, Graphnet would do its own negotiations.

Senator SCHMITT. How many individuals are there involved in those negotiations?

Mr. WEINSTEIN. Just a couple, really. If you're talking about total number of employees, we have about 700 employees total.

Senator SCHMITT. Is the international marketing effort by Graphnet sufficient to be able to tap that market? Mr. Knapp has suggested that it only takes very aggressive marketing to get into these international markets.

Mr. WEINSTEIN. Well, I'm not sure. If you're talking about marketing to customers, marketing the service to the customers, we can't even begin to market the service to the customers because we don't have the operating agreements. We don't have the service to offer right now. We have to have an operating agreement with a foreign country first. Once we have that, getting the circuits is relatively straightforward, at least from Comsat or from another IRC, and then we would be in a position to market and offer our services.

We're not in a position to even begin to market the services right now. But when I say the services, I mean the international services. We do market services, and we serve practically—well, I would say a very, very large number of the largest companies in the United States.

Senator SCHMITT. Mr. Weinstein, I'm very confused now, because I thought your problem was that you needed a single U.S. entity, with which you could interface, so that that entity could interface with foreign governments or foreign administrations. Is that correct?

Mr. WEINSTEIN. Not precisely. As I suggested in my testimony, there are really three ways by which a domestic carrier can go about doing it, and that is in fact one of the ways—the domestic carrier could go to the single entity. I'm not suggesting that the single entity, by the way, should own the facilities. I was leaving

the ownership of the facilities exactly the way it was proposed in the bill, and that would be the consortium that would own the facilities.

Graphnet, as a domestic carrier, could become a member of the consortium and therefore obtain an ownership interest in those circuits which it needs to service internationally. That would be No. 1.

No. 2, if we didn't want to acquire an ownership interest in those facilities, we could then lease the facilities from members of the consortium. We could go to one of the IRC's and just lease the facilities, just a pipeline. I'm not talking about interconnecting with them now. I'm just talking about leasing the circuit that goes overseas.

Senator SCHMITT. Can't you do that now?

Mr. WEINSTEIN. No. Well, we could lease the circuit, but we don't have anybody to connect the circuit with. It only goes halfway. It only goes to the middle of the ocean and we don't have anyone to connect with at the midpoint.

Senator SCHMITT. But that's a negotiation problem.

Mr. WEINSTEIN. That's exactly the point.

Senator SCHMITT. It is marketing, because they're the ones who are going to receive your services.

Mr. WEINSTEIN. Well, I didn't know if you meant marketing in the United States or marketing overseas.

Senator SCHMITT. I meant marketing. That's a neutral term. It happens all over the world. It just happens your customer is a foreign government in most instances.

Mr. WEINSTEIN. No, our customers are U.S. consumers.

Senator SCHMITT. But on the other end, you're trying to provide an interface between the customer here and the customer there.

Mr. WEINSTEIN. I see what you're saying. To a certain extent, yes.

Senator SCHMITT. You can line up that other customer.

Mr. WEINSTEIN. Well, we're not proposing to line up the customer on the overseas side. We are merely trying to serve the U.S. customers who are communicating with the foreign customers over in another country, those people. And with the operating agreement, we would have some sort of an arrangement with the foreign communications enterprise to divide the revenues going each way.

Senator SCHMITT. But you can't get that agreement, is that right?

Mr. WEINSTEIN. That's right. We don't propose to actually go and market it in a foreign country. We would merely interconnect with the communications company in the foreign country.

Senator SCHMITT. I understand. But you're trying to sell a service to a foreign entity, in the real sense of the word. You're trying to negotiate with them, saying, we've got customers that want to do something within your administration's jurisdiction.

Mr. WEINSTEIN. Right.

Senator SCHMITT. Will you give us access to those lines, and here's what's in it for you.

Mr. WEINSTEIN. Right, that's correct.

Senator SCHMITT. And you can't get that. They say, there's not enough in it for us.

Mr. WEINSTEIN. Well, it's not exactly that. Let me give you an example. Maybe with a short example, I could probably place this in a context that you will understand what the problem is here.

Let's assume that you are a foreign country. I don't want to name one, but you're a foreign country. The three of us sitting here are three U.S. international carriers, and the people in the back of the room here, the audience, are U.S. consumers. Now, these people in the back of the room represent the consumers that today are going to send a telegram to your country, and you know that. You've got this many telegrams that are headed for your country.

Now, you as a businessman don't really care whether it comes—which one it takes.

Senator SCHMITT. I'm a country?

Mr. WEINSTEIN. Right, you're the foreign administration. Now, you know this number of messages, how many people we have sitting in the room. There are going to be that many messages going to your country today. One way or the other, those messages are destined for people that live in your country and they're going to get there.

Now, would you rather deal with all three of us or would you rather deal with maybe four or five more people here that you have to connect with and figure it all out, and divide up your revenues with, or would you rather just deal with one guy? I mean, what is the difference? You're going to get the same amount of traffic whether you deal with one person or whether you deal with 100 people.

Senator SCHMITT. But I'm going to get it at a better price if I deal with several.

Mr. WEINSTEIN. Well, if you can trade us off against each other—and in fact that is happening, that is right. That is because we are being traded off against each other.

Senator SCHMITT. But we have examples of companies like Graphnet who have been able to negotiate an agreement with foreign countries, right?

Mr. WEINSTEIN. I'm sorry?

Senator SCHMITT. There are examples of U.S. companies that have been able to negotiate agreements with foreign countries, right?

Mr. WEINSTEIN. No.

Senator SCHMITT. Well, maybe I misunderstood.

Mr. WEINSTEIN. Well, the established international record carriers of today, yes.

Senator SCHMITT. What about TRT? Didn't they come on the scene recently?

Mr. WEINSTEIN. TRT has been on the scene for a number of years, although they were serving the southern route, the Latin American, Central American, and South American countries. After years of trying, they finally established an operating agreement with Italy.

Now, I'm not familiar with how many operating agreements they have. But as I best understand it—and maybe Mr. Knapp—I'm sure he does have the specific information of how many countries TRT has interconnection agreements with. Out of the Western European nations, I believe it is only Italy.

In fact, there is an example of how one company was able to negotiate, in one manner or another, an agreement with a country, Italy. And they funnel their traffic to other Western European countries through Italy, because Italy did negotiate an agreement with them.

Senator SCHMITT. Mr. Knapp, you're shaking your head.

Mr. KNAPP. They started with Italy, yes. But they have several dozen agreements around the world currently.

Mr. WEINSTEIN. I'm talking about Western Europe, now. How many agreements do they have in Europe?

Mr. KNAPP. U.K., Germany, France. I don't know about the Nordic countries. But they have several dozen agreements around the world.

Mr. Lubetsky will be here to testify before this committee in a day or two, and he is better prepared to respond to that question than I am. But the point, I guess, that I again would make is that we are living in a multinational world. If enough multinational companies find that the Graphnet services are good and valuable—and as far as I am concerned, they are good and valuable. They are a strong component, a new component, within the domestic telecommunications market of the United States, the competitive telecommunications market of the United States, and their services are good. And if enough multinational companies who reside in the United States, as well as in many nations around the world, feel those services are good and desirable to have, they in turn will generate the groundswell in their countries for the provision of those kinds of services.

But you get back again to the decision of that foreign administration as to how it wishes to provide to its consumers those kinds of services. And I'm saying there is evidence that new carriers come on the scene and do indeed negotiate new agreements with a foreign administration from time to time, if, as you say, Senator, if it is in their best interest.

But to legislate that it has to be in their best interest to accept all domestic U.S. competing carriers, to me is incredulous. It's impossible.

Senator SCHMITT. Mr. Chairman, we have a vote on and I would like to yield, first of all, to you, but then follow up with some other questions.

Senator HOLLINGS. All right, the committee will be in recess to attend this vote.

[Brief recess.]

Senator SCHMITT [presiding]. The committee will come back to order.

Gentlemen, I would like to explore with you the consequences of a major restructuring of the ownership of international facilities. For example, there would be the problem of valuation of the facilities that would be transferred.

We have seen this effort in the *Penn-Central* case, and that is still in the courts.

Would any of you like to comment on the valuation problem?

Mr. KNAPP. Senator, I just want to comment that I would be the wrong one to address it, since I don't support that aspect of it.

Senator SCHMITT. I understand that. We also have to explore the consequences of various alternatives.

Mr. KNAPP. I will defer.

Mr. KUYPER. I certainly think there would be problems. There would probably have to wind up being some kind of arbitrary decision that would establish a depreciated value or some kind of current value of the amount of various facilities that went in at different times or went in on different cost bases. The revenue capability of those circuits today are the same as a new one. You would have a great area of difference.

Mr. WEINSTEIN. I have a very brief comment. You should first of all understand that Graphnet is a resale carrier and we do not own the facilities, even domestically. Whether we would do so internationally is something that I really don't know at this point. So I can't speak from experience, from Graphnet's experience. I can only say that the process that is envisioned by the bill is not such an unusual process. The Government in many different contexts takes property by eminent domain. It is a fairly common thing, and usually the Government can negotiate with the private enterprise or, I should say, the private owners of whatever it is that the Government is taking over. And if in fact they don't come to an agreement, then there are mechanisms, arbitration as well as courts, which can satisfy the interests of both parties.

Senator SCHMITT. The proposal in S. 611 has no mechanism for review of a decision made by the arbitration panel or the FCC? Do you think there should be review?

Mr. KUYPER. I would like to respond to that. I feel that a review process would be entirely appropriate for the task force approach. There is some question as to whether after the fact review can be effective, and so forth. I feel that if there is an effort made to make it effective, it can be.

The situation is such that if the provider of the facility has the responsibility for its service, you are going to get maximum effective interest, whatever happens to that situation, and a meeting of the minds is going to be balancing on a one to one basis. Once you put in this extra layer and start to impose secondary judgments and other aspects of it, the review process to me becomes much more complicated yet, because the additional carriers may be subjected to this manager in some fashion to produce some other desired result that may not even be in the interest of those carriers, and you then have head-on conflict between the approval and the review.

Obviously, if you go to this manager and give him immediate authority, you don't have a review process that makes any sense, because by definition you approve it in advance.

Senator SCHMITT. Any other comments on that issue?

Mr. KNAPP. I believe, Senator, that the experience of competing carriers, of A.T. & T. and Comsat, is such that they will make decisions in the best interest of serving the consumers. I think that those interests are the same on both sides of the Atlantic and I would not foresee a real problem with the implementation of the task force.

With NTIA chairing it, I think that you will arrive at a consensus position with respect to the construction of the facilities.

Senator SCHMITT. With respect to Comsat, there has been a steady line of criticism of Comsat in various ways. One controversial provision of the present law is that the President appoints three members of the Comsat board of directors.

Do you believe that this provision continues to be appropriate in view of Comsat's present status and success?

Mr. KNAPP. No, I think it is entirely inappropriate. I think perhaps in the formative days, at the time when the Congress decided that the Comsat organization should be created, that perhaps it was appropriate. But we have to understand that happened in 1962. We have gone through a period of 17 years here during which time Comsat has proved to be a very, very viable entity, a very, very profitable entity, and one which is totally able to stand on its own two feet as a private corporation.

It is traded on the New York Stock Exchange. It has all the aspects of a private organization. I see no longer any reason for involvement on the board of directors with Presidential appointees.

Mr. KUYPER. I guess our feeling is that Comsat is capable of representing themselves very effectively, and that to the degree that there is equitable participation in the provision of their circuits, we have no problem with the existing situation, other than perhaps that the rates might be a little more favorable.

The position that we take is that if Comsat should be allowed to go to the retail customer, then we feel there should be a very strong quid pro quo, that the carriers can be permitted to go also on their own satellite systems.

Senator SCHMITT. Mr. Knapp has indicated he thinks that the foreign entities, foreign governments, are misled by Comsat's apparently favored status. Do you agree with that, Mr. Kuyper?

Mr. KUYPER. I don't know that I could answer that question, in all fairness.

Senator SCHMITT. How do you think the deletion of that provision, the requirement that the President appoint three members of the Comsat board of directors, would affect Comsat? Can you see any significant adverse effects on Comsat if that were deleted?

Mr. KUYPER. Not offhand, personally, I don't.

Senator SCHMITT. Mr. Knapp?

Mr. KNAPP. No, I don't believe so, sir. I don't think it should have any impact one way or the other. I think that within the FCC, perhaps within other agencies of Government, there is a feeling of a very special relationship between Comsat and the various Government agencies, which may be perpetuated by the existence of the three Presidential appointees on the board of Comsat. I just don't think that that is a necessary ingredient for Comsat remaining in its role as a U.S. representative in Intelsat or perhaps any future role the Congress may decide in order to permit it to become a retail carrier.

Senator SCHMITT. Mr. Weinstein, under your proposal for the ownership of international facilities, what mechanism could be established to insure that those facilities were operated efficiently and effectively and in innovative ways, if it is basically a monopoly operation?

Mr. WEINSTEIN. First of all, I did not make a proposal with respect to the ownership of the facilities, but merely as to the use

of the facilities. Under my proposal it really—the significant point is not that we own the facilities but, I think, what your question is getting to, how are those facilities going to be used? If we have a single entity which has negotiated operating agreements with each foreign country, that all U.S. carriers could avail themselves of, then you could have a truly competitive situation, and each carrier would make its own choice based on what the consumers desire and the demands that are made by consumers and the users.

My simple answer is that in the competitive marketplace you will always end up using—and I am talking about in a truly competitive marketplace, and not the type of competition that we have today, if you can call it competition—in a truly competitive marketplace prices will be brought down by competition, facilities will be used efficiently, and they will be used in a manner that will best serve the interests of the consumers who are using the services being offered.

I hope I answered your question.

Senator SCHMITT. Well, not really. I was under the impression that you thought that the present competitive situation in international record carriers should be changed to one which was less competitive, if not noncompetitive.

Mr. WEINSTEIN. No, not at all. Quite the opposite. We are proposing a means by which there would be one operating agreement that would be signed between the United States, on one hand, the single entity probably, and the foreign government, on the other hand. All carriers would be able to avail themselves of that operating agreement, master operating agreement so you don't have a half a dozen individual ones; you just have one blanket operating agreement.

Then all U.S. carriers could compete, under the terms of that operating agreement. There would be no restrictions. Every domestic carrier, including Western Union—we've had testimony today—

Senator SCHMITT. Except those restrictions some foreign entity might put in the agreement.

Mr. WEINSTEIN. Well, that's true. To the extent that a foreign entity does not wish to provide a particular service to the public in its country, you probably would have a difficult time forcing them to offer services that they don't want to offer.

But you have to really distinguish between two sets of services: You have a set of services that are presently being offered today by today's carriers; and then you have another set of services, new innovative services, some of which Graphnet is offering today domestically.

Senator SCHMITT. But you're still going to have a central managing and planning authority; right?

Mr. WEINSTEIN. Yes. For facilities construction. Just as the bill proposes.

Senator SCHMITT. What is in that that is going to stimulate efficiency and innovation?

Mr. WEINSTEIN. Well, I am having a little trouble understanding what you are driving at.

What will happen will be that all U.S. carriers, under our proposal, will be able to offer all their services and interconnect directly.

Senator SCHMITT. But you're separating management and ownership right; isn't that what you're advocating?

Mr. WEINSTEIN. Well, let me put it this way: That is what the bill advocates, S. 611. And I am supporting that; that's correct.

Senator SCHMITT. In such a bifurcation or separation, don't you run, particularly on the management side, into a major problem in instituting efficiency and new innovative methods of delivering services?

Mr. WEINSTEIN. Well, no, because the single entity, the international facility manager, is not offering any services to the public. That is like a pipeline company; that is the company—

Senator SCHMITT. But they are making basic management decisions on what facilities are created.

Mr. WEINSTEIN. Just facilities. I mean, a circuit is a circuit. The same circuit is used today for private line services, for telex services—

Senator SCHMITT. But the circuit today is not the circuit that was used 10 years ago; it is a better circuit.

Mr. WEINSTEIN. Well, sure, because we're using maybe satellite technology today that we weren't using 20 years ago. To that extent, we have improved facilities. But just because we have a satellite today which may offer a better circuit than a cable—and, by the way, I don't know that that is necessarily the case—

Senator SCHMITT. Well, I am looking for—

Mr. WEINSTEIN. I am trying to distinguish between services and facilities. And what I am suggesting is that the facilities will be owned by this consortium, but that consortium will use those facilities in a way that it sees fit to be able to offer its services to customers. It would be the members of the consortium, the carriers themselves, that are offering services to the public. It could be Graphnet, ITT, RCA, Western Union.

Senator SCHMITT. But where are the incentives for the introduction of new technical capabilities through, new facilities?

Mr. WEINSTEIN. Well, I don't think that there is a particularly close tie between the facilities and the services. I think those are two separate questions.

I think that what the bill is striving towards is having a unified approach toward international negotiations with respect to building these facilities so you don't have the hassles that we have gone through in the past between whether we throw another satellite up into orbit or whether we build a new cable.

From Graphnet's perspective, you see, we would like—even today Graphnet leases facilities domestically from A.T. & T. and other carriers. We will lease our facilities from the carrier that offers us the cheapest and most reliable private line circuit. We then use that circuit to provide—to put together our own network and offer our own services.

Now, if A.T. & T. offers a circuit from New York to Washington for x dollars and MCI offers it for x minus y dollars, we're going to lease the circuit from MCI. Now, I am assuming that the circuits are comparable circuits.

Senator SCHMITT. But MCI is likely to offer you a more competitive service, a newer and more modern circuit system.

Mr. WEINSTEIN. That's right.

Senator SCHMITT. Frankly, I don't see where, in the arrangement that you have supported, that there is the incentive to put in newer and more modern circuits under joint ownership.

Mr. WEINSTEIN. In other words, you're suggesting that because one entity would own both, all transmission facilities—

Senator SCHMITT. I am afraid that by creating this system envisioned by S. 611 which you support, that you have done to the international market what everybody argues we have allowed to happen to the domestic market through A.T. & T.—

Mr. WEINSTEIN. In other words, you're suggesting that there is one entity that controls all technology, essentially, on an overseas basis, that that technology would not move forward as rapidly. I don't know, really, how to address that, other than to say I think there are incentives by the owners of the facilities to offer the cheapest and most efficient facilities to the people who are going to be using those facilities.

At this point you may be getting back to one step beyond the people who own the facilities back to the point of the people who are manufacturing those facilities. In one case, you have certain companies that are building satellites, and essentially those companies are going to be competing with the companies that are building cables. I guess in the United States the cables are built by Western Electric, as best I understand it; I am not sure about that, though. And to that extent, you have competition in the manufacturing industry. People who are developing this new technology, I can't believe that if there was a new technology that were developed in the next few years, something better than satellites and better than cables and less costly than each, that this consortium that owned the international facilities would not, in fact, move forward to make use of this new technology.

I guess you have to bear in mind the fact that, yes, each of the companies has a particular private interest, financial interest in what develops in the future, but at the same time this single entity has to weigh the public interest with the private interest. And I dare say that the public interest should certainly be an overriding factor over the private interest of the individual carriers. And if that facilities manager deemed it appropriate to go with a new type of technology because of the inherent advantages of that technology, then, in fact, that would be the decision that would be made on behalf of the United States. You would still have to worry about convincing the countries on the other side that that is the technology that should be used, and that is always going to be a problem.

Senator SCHMITT. Mr. Knapp, would you care to comment? You have addressed this to some degree in your testimony.

Mr. KNAPP. I quite frankly think that we are at the point of having a consortium, if you will. We have got a monopoly supplier of satellite service today; namely, Comsat. And you have a, if you will, a consortium in cables—A.T. & T. and the other international service carriers.

Dr. Charyk commented this morning that over 80 percent of those facilities are dedicated to the use of A.T. & T. for voice communications services. I see no reason to go into this restructuring, in this creation and transfer of ownership. I think it is an unnecessary step, totally. I think that we are there now. I think that we have—again I will say we have got a monopoly supplier of satellite services; we've got a consortium arrangement with respect to cables. If a third technology arises, we will deal with it at that time, and I would suspect we would probably move into the 1980's in providing new and advanced circuitry and that those people who are interested in investing in optical fiber cables will do so.

Senator SCHMITT. Is it your feeling, Mr. Knapp, that, except for having to deal with foreign correspondents the international telecommunications system can operate under most of the same ground rules that we would establish for domestic telecommunications?

Mr. KNAPP. No. I think we probably come from a different point of view. I think, in the case of the domestic, we've got control over it. We have a situation where you've got a dominant carrier; namely, A.T. & T. In the case of the international, we have two, in effect, two sources of facilities provision. We have very aggressive competition in the provision of record data services. I think the international service and the international market is distinctly different from that that we have domestically, and I believe that we have taken, as far as this testimony is concerned before this committee, we have taken two different approaches to international and domestic.

As you have heard today, we are proposing that the existing structure which we have is generally satisfactory. Perhaps the competitive environment in the record data field can be maintained by allowing us to prepare ourselves for the ultimate competition from Western Union domestically. We frankly believe that International Voice has a monopoly and probably should stand as a monopoly for international purposes. And, of course, that has no relationship whatsoever to the facts that are existing within the domestic marketplace where both the Commission and this Congress have been wrestling for some period of time as to how to increase competition and how to change the status quo in the United States, and we are all party to that.

ITT has invested \$150 million in three specific systems to participate in that competition. So I think you will find that ITT's prior testimony in the domestic area is substantially different than its testimony in the international area.

Senator SCHMITT. But where in the domestic market we have control over both ends and everything in between, we don't have that in the international market. One end is controlled by a foreign entity although there is some leverage there presumably.

What you are saying is that the primary problem to resolve is the need for coordination in planning of the facilities; is that correct?

Mr. KNAPP. That is correct.

Senator SCHMITT. But otherwise you would like to see as much competition as possible within international services, if not, as time progresses, in the facilities.

Mr. KNAPP. At the retail level.

Senator SCHMITT. Understanding that the international area even more than domestic, requires the joint use of facilities for most, if not all services. Is that correct?

Mr. KNAPP. That is correct.

Senator SCHMITT. But you might foresee a time, particularly with respect to satellites, when there could be competitive satellite services consistent with that environment. Is that possible?

Mr. KNAPP. As I state in my testimony, I believe the competition obviates the necessity for rate and facility relation. I am not predicting that ITT would put up their own satellite system tomorrow.

Senator SCHMITT. But you would not eliminate that possibility in the future?

Mr. KNAPP. I think, again, you make a business judgment as to whether it was appropriate in light of every other facility available to you.

Senator SCHMITT. There has been some criticism of the FCC's activities in the international arena. Is this partly because of a lack of understanding of the technical aspects of providing international record services?

Mr. KNAPP. No, I think it goes back to a very fundamental issue. For whatever reasons—and I have never been able to find out the reason—there seems to be some very strange bias on the part of the Commission staff in favor of satellite technology. As a carrier, I need both facilities.

Senator SCHMITT. Well, that's what I am asking you. Isn't that lack of understanding of the differences in relationships between cable and satellite at the core of the problems that you have with the FCC in the international arena; that you need both?

Mr. KNAPP. We have stated it innumerable times. Europeans have stated it innumerable times. I can honestly profess that I cannot explain the position of the FCC with respect to the way in which it evaluates the relative cost of cable versus satellite. They use a way that is not rational.

I am sure if Mr. Ferris were here, he would have another answer.

But they have an irrational bias in favor of satellites. I don't have a bias in any direction. I need both facilities. The Europeans need both facilities because they are carriers just like we are. And we need an entire array. We need it in sufficient quantity such that the customers who may prefer a cable circuit to a satellite circuit, or a satellite circuit to a cable circuit, depending upon what his needs are, that they are there when that need arises.

And I do not understand why the FCC cannot perceive that very simple market fact, and, therefore, I am to this day very confused as to why they have intruded to the extent that they have in the planning process.

Senator SCHMITT. Mr. Kuyper.

Mr. KUYPER. The feeling that I have is very similar. It is a little hard at times to determine why the FCC has pushed so hard to protect the satellite development, other than its initiative asking, I guess.

As a carrier, we want redundancy. We want alternate routing. We want technical performance that gives the customer reasonable

service. There are technical features in both satellite and cable that make them specifically desirable for different applications.

At the present time, something over 70 percent of our facilities back to the U.S. mainland are in satellites. The problems caused by delay, even on voice transmission of the satellite circuits, has increased as the percentage of traffic on satellite has increased; the dissatisfaction of the customer has also increased.

There is no question that a balancing of both cable and satellite is extremely desirable, and while Mr. Knapp expressed the European countries' view, I can certainly testify that the Asian countries—Japan, Australia, and so forth—concur in that.

Senator SCHMITT. Does this basically result from the fact that satellite circuit costs are not included in the rate base, whereas cable costs are, and that forces you in the direction of satellites; is that correct?

Mr. KUYPER. No. I think that, as a carrier, certainly, when you lease a circuit from Comsat or Comstar or whether you invest in a cable, there is a financial impact on a company there. But I can tell you that, from our point of view, that is, by far, a secondary consideration. Everything we look at is on the basis of the service to the customer in meeting the technical performance and service demands. You go with one or the other, even when inefficiencies to some degree creep in because of the need for that balance. That is the price of having service available when it is needed.

Senator SCHMITT. Thank you, gentlemen. We appreciate your testimony on the bills. I understand that we are meeting again tomorrow at 2 p.m. in this room, 235.

The hearing is adjourned.

[Whereupon, at 4:20 p.m., the hearing was adjourned, to be reconvened on Thursday, May 10, 1979.]



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